SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1914.

No. 623.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE, &C., PETITIONER,

VS.

THE FORTY-TWO BROADWAY COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

INDEX.

	Original.	Print.
Caption	a	1
Transcript from the District Court of the United States for the Southern District of New York	1	1
Writ of error	1	1
Summons	2	2
Complaint	4	2
Exhibit A.—Plaintiff's return	9	5
Exhibit B.—Plaintiff's amended return	15	8
Exhibit C.—Claim for refund	23	11
Answer	30	15
Stipulation waiving jury	33	16
Agreed statement of facts	34	17
Exhibit 1.—Certificate of incorporation of The Forty-Two Broadway Co	41	21
Exhibit 2.—Notice of demand for taxes assessed	45	23
Exhibit 3.—Letter Forty-Two Broadway Co. to collector internal revenue, dated April 28, 1911	46	23
Exhibit 3A.—Receipt for taxes, year 1910	47	24
Exhibit 4.—Letter Baldwin & Hutchins to collector internal revenue, dated April 15, 1912	47	24
Exhibit 5.—Letter collector internal revenue to Baldwin & Hutchins, dated April 18, 1912	48	24
Exhibit 6.—Letter Commissioner Internal Revenue to collector internal revenue, dated June 5, 1912	49	25
Exhibit 7.—Agreement, dated April 12, 1902, between George A. Fuller Company and The Forty-Two Broadway Company.	51	26

Transcript from the District Court of the United States for the Southern District of New York—Continued.	Original.	Print.
Opinion, Holt, J	67	35
Order for judgment	71	37
Judgment	73	38
Assignment of errors	74	39
Citation	77	40
Stipulation as to record	78	40
Clerk's certificate	79	41
Opinion, Ward, J	80	41
Judgment	84	44
Clerk's certificate	86	44
Stipulation as to return to writ of certiorari	87	44
Clerk's return to writ of certiorari	88	45
Writ of certiorari	89	45

a United States Circuit Court of Appeals for the Second Circuit. Charles W. Anderson, collector of internal revenue of the United States of America for the Second District of New York, plaintiff in error (defendant below), vs. The Forty-two Broadway Company, defendant in error (plaintiff below.) Transcript of record. Error to the District Court of the United States for the Southern District of New York.

1 *Writ of error.*

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the judges of the District Court of the United States for the Southern District of New York, greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the district court before you, or some of you, between The Forty-two Broadway Company, plaintiff, vs. Charles W. Anderson, collector of internal revenue of the United States of America for the Second District of New York, defendant, a manifest error hath happened to the great damage of the said defendant as is said and appears by his complaint, we being willing that such error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the judges of the United States Circuit Court of Appeals for the Second Circuit, at the city of New York, together with this writ, so that you have the same at the said place, before the judges aforesaid, on the 17th day of January, 1914, that the record and proceedings aforesaid being inspected, the said judges of the United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

2 Witness, the honorable George C. Holt, United States district judge, Southern District of New York, this 18th [L. S.] day of December, in the year of our Lord one thousand nine hundred and thirteen and of the independence of the United States the one hundred and thirty-eighth.

ALEX. GILCHRIST, JR.,
Clerk of the District Court of the United States of America, for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed.

GEO. C. HOLT,
U. S. District Judge.

(Filed December 18, 1913.)

Summons.

United States District Court for the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

To the above-named defendant:

You are hereby summoned to answer the complaint in this
3 action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Hon. George C. Holt, judge of the District Court of the United States for the Southern District of New York, at the city of New York, this 4th day of November, in the year one thousand nine hundred and twelve.

ALEX. GILCHRIST, Jr.,
Clerk.

BALDWIN & HUTCHINS,
Plaintiff's Attorneys.

Office and post-office address, 27 Pine St., borough of Manhattan, New York City.

(Filed November 8th, 1912.)

4 *Complaint.*

United States District Court for the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE of the United States of America for the Second District of New York, defendant.

The plaintiff, by Baldwin & Hutchins, its attorneys, complains of the defendant and alleges:

I. That the plaintiff at all the times hereinafter mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of New York.

II. That the defendant at all the times hereinafter mentioned was, and now is, collector of internal revenue of the United States of America for the Second District of New York.

III. That this action arose under a law of the United States providing for internal revenue, being section 38 of the act of Congress approved August 5th, 1909, known as the United States corporation tax law and acts amendatory thereof and supplemental thereto.

5 IV. That in accordance with the provisions of such section of said act, the plaintiff on or about the 27th day of February, 1911, duly filed its return for the year ending December 31st, 1910, a copy of which return is hereto annexed, marked "A," and made a part of this complaint.

V. That on or about the 10th day of April, 1911, the plaintiff, not voluntarily, but under duress and protest, and upon the demand of the Commissioner of Internal Revenue of the United States and of his duly authorized revenue agent, Robert O. Deyer, Esq., and of this defendant, filed an amended return for the year ending December 31st, 1910, a copy of which amended return is hereto annexed marked "B," and made a part of this complaint; that such amended return and the form thereof was made out in accordance with the demands of the said commissioner, the said revenue agent, and this defendant.

VI. That thereafter and on or about the 29th day of April, 1911, the plaintiff, not voluntarily, but under duress and protest, and upon the demand of the defendant, was compelled to and did pay to the defendant, and the defendant received, the sum of $1,781.36, which sum the defendant demanded and received by virtue of his office as collector as and for the alleged tax purporting to be due from the plaintiff to the United States for the year 1910 under said corporation tax law.

VII. That on or about the 15th day of April, 1912, the plaintiff duly made an appeal and claim to the Commissioner of Internal Revenue according to the provisions of law in that regard, and

6 according to the regulations of the Secretary of the Treasury, claiming that the said amount paid as aforesaid should be refunded to the plaintiff; that a copy of said appeal and claim is hereto annexed marked "C" and made a part of this complaint.

VIII. That on or about the 5th day of June, 1912, a decision of the said commissioner therein was had, and the said appeal and claim of the plaintiff were rejected by the said commissioner.

IX. That the said alleged tax and the assessment by the Commissioner of Internal Revenue of the United States, upon which it was based, were illegally and improperly made and levied, and were and are illegal and void.

X. That the plaintiff is and at all the times hereinafter mentioned has been a realty corporation, and is and at all such times has been engaged in no other business or occupation; that the plaintiff was organized for the purpose of acquiring land and constructing an office building thereon at 42 Broadway in the city of New York, and has at no time transacted any other business; that the capital stock of the plaintiff was originally and has always been only $600;

that the funds with which it acquired such land and constructed and operated such office building were obtained, with the exception of the $600 capital stock before referred to, entirely through loans made to the plaintiff; that since its organization in April, 1902, the plaintiff has been operated at all times at a loss and has had or earned no net income, and during the year ending December 31st, 1910, had or earned no net income.

XI. That for and during said year ending December 31st,
7 1910, the ordinary and necessary expenses of maintenance and operation of the business and properties of the plaintiff included interest actually paid and accruing on bonds of the plaintiff, or interim certificates therefor, secured by first and second mortgages on the said property, such bonds or interim certificates being $3,250,000 (upon the principal of which $250,000 was paid on or about June 1st, 1907), and $1,500,000 respectively, and interest actually paid and accruing on other indebtedness of the plaintiff represented by debenture bonds and notes of the plaintiff, without which bonds, interim certificates, mortgages and indebtedness, and without the payment of which interest thereon, the plaintiff could not have maintained and operated its business and properties.

XII. That such interest actually accrued and was actually paid by the plaintiff and was a part of the ordinary and necessary expenses of maintenance and operation of the business and properties of the plaintiff for and during the said year ending December 31st, 1910, and that such interest is more particularly set forth in the said return, a copy of which is hereto annexed, marked "A," and in the said amended return, a copy of which is hereto annexed, marked "B," to which return and amended return the plaintiff refers for the items and particulars of such interest.

XIII. That such interest, except to the extent of $36, was not allowed by the said commissioner, the said revenue agent, and this defendant; that such interest in the said return of the plaintiff was included as a part of the ordinary and necessary expenses of maintenance and operation of the business and properties of the
8 plaintiff, but that upon the demand of the said commissioner, of the said revenue agent, and of this defendant the plaintiff was compelled, under duress and protest, to omit such interest in its amended return as a part of the ordinary and necessary expenses of maintenance and operation of the business and properties of the plaintiff, although claiming in such amended return that such interest should be so included.

XIV. That if such interest is allowed and included in and as a part of the ordinary and necessary expenses of maintenance and operation of the business and properties of the plaintiff, the plaintiff had no income upon which a tax under the said corporation tax law could or should be assessed or levied for the period above mentioned.

Wherefore the plaintiff prays for judgment for the sum of $1,781.36, with interest thereon from the 29th day of April, 1911, together with the costs and disbursements of this action.

BALDWIN & HUTCHINS,
Attorneys for Plaintiff.

Office and post-office address, 27 Pine Street, borough of Manhattan, New York City.

STATE OF NEW YORK,
County of New York, ss:

Lester S. Holmes, being duly sworn, deposes and says that he is the president of The Forty-two Broadway Company, the plaintiff herein; that he has read the foregoing complaint and knows the contents thereof; that the same is true to the knowledge of deponent, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes it to be true;
9 that the reason why this verification is not made by the plaintiff is that the plaintiff is a corporation and deponent is an officer thereof, to wit, president.

LESTER S. HOLMES.

Sworn to before me this 4th day of November, 1912.

[SEAL.] CHRISTINA SPRUNG,
Notary Public, Kings County, No. 18.

Certificate filed in New York County, No. 29, Reg. No. Kings 4362, Reg. No. N. Y. 4155.

Plaintiff's return.

"A."

United States internal revenue.

Return of annual net income.

(Section 38, act of Congress approved August 5, 1909.)

Miscellaneous corporations.

This return is made under protest and without prejudice.

Return of net income received during the year ending December 31, 1910, by The Forty-Two Broadway Company, a corporation, the principal place of business of which is located at Great River, in the State of New York, Suffolk County, being a realty company solely engaged in the owning and renting of an office building from January 1, 1910, to and including December 30, 1910.

1.	Total amount of paid-up capital stock outstanding at close of year	$600.00
10 2.	Total amount of bonded and other indebtedness outstanding at close of year without interest (see note "1" annexed)	889,989.93

3.	Gross income (see note A) actually received during 1910	$381,182.95
	Actually earned in 1910	389,554.19
	(The books of the company will show a different gross income credited to 1910 than that actually earned, due to the fact that rents are applied in the books to the period in which the same are collected, except in a few instances where special treatment of an account has been made.)	
	DEDUCTIONS.	
4.	Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation exclusive of interest payments. (See note B.) See note "2" annexed	434,660.81
5.	(a) Total amount of losses sustained January 1 to December 31 not compensated by insurance or otherwise	None.
	(b) Total amount of depreciation January 1 to December 31	None.
	6. Total amount of interest paid January 1 to December 31	
11	on an amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year. (See note "2" annexed.)	
7.	(a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof	65,628.49
	(b) Foreign taxes paid	None.
8.	Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax	None.
	Total deductions (see note B)	$500,289.28
9.	Net income	None.
10.	Specific deduction from net income allowed by law	5,000.00
11.	Amount on which tax at 1 per centum is to be calculated for assessment	None.

12 STATE OF NEW YORK, *County of New York, to wit:*

William P. Jeffery, president, and Roger S. Baldwin, treasurer, of the The Forty-Two Broadway Company, corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated.

WILLIAM P. JEFFERY,
President.

ROGER S. BALDWIN,
Treasurer.

Sworn and subscribed to before me this 20th day of February, 1911.

CHRISTINA SPRUNG,
Notary Public, Kings County, No. 113.

Certificate filed in New York County, Reg. No. Kings 4362—Reg. No. N. Y. 2367.

13 NOTE A.—Gross income shall consist of the total of the gross revenue derived from the operation and management of

its business and properties, together with all amounts of income from other sources, including dividends on stock of other organizations subject to this special excise tax received, as shown by entries upon its books, from January 1 to December 31 of the year for which return is made.

NOTE B.—The deductions authorized shall include all expense items under the various heads, acknowledged as liabilities by the corporation making the return, and entered on its books from January 1 to December 31. Amounts of income expended in paying dividends on stock, preferred or common, or in making permanent improvements, in betterments, etc., or in any way transferred to capital account, are not proper deductions in ascertaining annual net income. Interest paid on mortgage indebtedness on real estate acquired by a corporation may be deducted in item 4, if the mortgage remains a lien on the property and the debt is not assumed by the corporation. The amount so paid and included in item 4 should, however, be separately stated under item 4.

NOTE C.—This form, properly filled out and executed, must be in the hands of the collector of internal revenue for the district in which is located the principal business office of the corporation making the return on or before March 1.

NOTE "1."—Total amount of bonded and other indebtedness outstanding on December 31st, 1910, without interest, was, as shown by the report, $889,989.93.

On December 30th, 1910, however, the amount of such indebtedness, without interest, was $5,080,489.93, which last mentioned
14 indebtedness approximated the indebtedness of the corporation from January 1, 1910, to December 30, 1910, on which last mentioned date the real estate of the corporation known as Forty-Two Broadway, in the borough of Manhattan, New York City, was transferred and sold, such real estate being transferred subject to the greater part of such last mentioned indebtedness, and the indebtedness of the corporation was reduced to the sum of $889,989.93 mentioned in the report.

NOTE "2."—The amount set opposite question No. 4, to wit, $434,690.81 includes interest on first mortgage, a lien on real property of company, securing bond of the company, accrued and paid in 1910		135,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued and paid in 1910		25,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued prior to 1910, but paid in 1910		76,527.77
Other interest on bonded and other indebtedness of the company, contracted in the maintenance and operation of the business and properties of the company, such interest being a liability incurred or paid as a necessary expense in the maintenance of the business and properties of the company. Total of such interest accrued and paid in 1910		47,715.16
Accrued prior to 1910, but paid in 1910		55,275.00
15 Insurance for 1910 paid in advance in 1909		5,400.83
Sundry operating expenses, including supplies, wages, etc.		89,743.05
		434,660.81

Plaintiff's amended return.

"B"

United States internal revenue.

Amended return of annual net income.

(Section 38, act of Congress approved August 5, 1909.)

Miscellaneous corporations.

This amended return is made under protest and without prejudice.

Return of net income received during the year ending December 31, 1910, by The Forty-two Broadway Company, a corporation, the principal place of business of which is located at Great River, in the State of New York, Suffolk County.

1.	Total amount of paid-up capital stock outstanding at close of year	$000.00
2.	Total amount of bonded and other indebtedness outstanding at close of year (see Note "1" annexed)	889,989.93
3.	Gross income (see Note ("A"); see note "2" annexed)	306,517.21
16	DEDUCTIONS.	
4.	Total amount of all ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation, exclusive of interest payments (see Note B); see note "3" annexed)	123,645.46
5.	(a) Total amount of losses sustained January 1 to December 31 not compensated by insurance or otherwise	None.
	(b) Total amount of depreciation January 1 to December 31	None.
17	6. Total amount of interest paid January 1 to December 31 on amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year (see Note "3" annexed)	36.00
7.	(a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof (see Note "4" annexed	
	(b) Foreign taxes paid	None.
8.	Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax	None.
18	Total deductions (see Note B)	$123,681.46
	9. Net income (see Note "5" annexed)	183,135.75
10.	Specific deduction from net income allowed by law	5,000.00
11.	Amount on which tax at 1 per centum is to be calculated for assessment	178,135.75

STATE OF NEW YORK,

County of New York, to wit:

William P. Jeffery, president, and Roger S. Baldwin, treasurer, of The Forty-two Broadway Company, the corporation whose amended return of annual net income is set forth above, being severally duly sworn, each for himself deposes and says that the foregoing report and the several items therein set forth are to his best knowledge and

belief, and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated.

WILLIAM P. JEFFERY,
President.
ROGER S. BALDWIN,
Treasurer.

Sworn and subscribed to before me this 10th day of April, 1911.

CHRISTINA SPRUNG,
Notary Public, Kings County, No. 113.

Certificate filed in New York County, Reg. No. Kings 4362—Reg. No. N. Y. 2367.

19 NOTE.—Gross income shall consist of the total of the gross revenue derived from the operation and management of its business and properties, together with all amounts of income from other sources, including dividends on stock of other organizations subject to this special excise tax received, as shown by entries upon its books, from January 1 to December 31 of the year for which return is made.

NOTE B.—The deductions authorized shall include all expense items under the various heads, acknowledged as liabilities by the corporation making the return and entered on its books from January 1 to December 31. Amounts of income expended in paying dividends on stock, preferred or common, or in making permanent improvements, in betterments, etc., or in any way transferred to capital account are not proper deductions in ascertaining annual net income. Interest paid on mortgage indebtedness on real estate acquired by a corporation may be deducted in item 4, if the mortgage remains a lien on the property and the debt is not assumed by the corporation. The amount so paid and included in item 4 should, however, be separately stated under item 4.

NOTE C.—This form, properly filled out and executed, must be in the hands of the collector of internal revenue for the district in which is located the principal business office of the corporation making the return on or before March 1.

NOTE 1.—Total amount of bonded and other indebtedness outstanding on December 31st, 1910, without interest, was, as shown by the report, $889,989.93.

20 On December 30th, 1910, however, the amount of such indebtedness, without interest, was $5,080,489.93, which last mentioned indebtedness approximated the indebtedness of the corporation from January 1, 1910, to December 30, 1910, on which last mentioned date the real estate of the corporation known as Forty-two Broadway in the Borough of Manhattan, New York City, was transferred and sold. Such real estate being transferred subject to the

bond of the corporation for $3,000,000 and interest thereon from December 1st, 1910, secured by a first mortgage on the Forty-two Broadway Building, and the indebtedness of the corporation, excluding such $3,000,000 bond, was reduced to the sum of $889,989.93 mentioned in the report.

NOTE "2." In the gross income of $306,817.21 reported, there is included interest from September 30th, 1910, on certain items, which interest was credited to the company on the closing statement for the purpose of adjustment at the time that the real estate of the company was transferred on December 30th, 1910, as set forth in Note "1," such closing being as of September 30th, 1910, such interest amounting to $17,379.13.

It is claimed on behalf of The Forty-two Broadway Company that such item of $17,379.13 does not and should not constitute income; that the same is in fact a part of the purchase price of the real estate of the company and figured as interest for the purpose of arriving at the amount to be paid for the property by the purchaser; that such item should be deducted from the income of $306,817.21 reported; and The Forty-two Broadway Company
21 claims that the gross income for the purpose of this report should be and is $289,438.08.

NOTE "3."—In the answer to question 4, being ordinary and necessary expenses of maintenance and operation of the business, etc., of the company, there is included only the direct cost of operating the building of the company, legal services, officers' salaries, and a commission paid for the sale of the real estate of the company.

The company further claims, however, as a part of the expense of maintenance and operation of the business and property of the corporation, that there should be included in the answer to question No. 4 of the within report the following:

Interest on second mortgage, a lien on real property of company, securing bond of the company, accrued and paid in 1910	135,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued and paid in 1910	25,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued prior to 1910, but paid in 1910	76,527.77
Other interest on bonded and other indebtedness of the company, contracted in the maintenance and operation of the business and properties of the company, such interest being a liability incurred or paid as a necessary expense in the maintenance of the business and properties of the company.	
Total of such interest accrued and paid in 1910	47,715.16
22 Total of such interest accrued prior to 1910 but paid in 1910	55,274.00
	339,516.93

The Forty-two Broadway Company claims that the answer to question No. 4 for the purpose of this report should be the amount reported, $123,645.46, plus the above interest items amounting to $339,516.93, making a total of $463,162.39.

NOTE "4."—In answering question No. 7 the amount is left blank. It is claimed, however, that the amount of taxes on the real estate of the company for the year 1910 should be apportioned for the period

from January 1st, 1910, to September 30th, 1910, the date as of which such real estate was transferred, and that the amount of $48,122.51 should be allowed as a deduction.

The contract for sale, under which such real estate was transferred, was executed April 8th, 1910, and provided for closing on July 30th, 1910. The closing date under such contract was, however, from time to time adjourned, until the final closing was set for and occurred on December 30th, 1910, but such closing was as of September 30th, 1910.

The taxes for the year 1910 became a lien on the property of the company on the second Monday of October, 1910. The contract for the sale of the property of the company provided that the amount of such taxes should be added to the purchase price of the building in case such taxes were paid by the company. The company did pay such taxes, amounting to $65,628.47, in October, 1910, and on the closing of the title of the property the total amount of such taxes was added to the purchase price of the building and in that way repaid to the company by the purchaser. The proportionate
23 amount of such taxes from January 1st, 1910 to September 30th, 1910, is $48,122.51.

NOTE "5."—The company filed a due and proper return for the year 1910 and files this amended return under the protest that it has already filed a return as required by law; that this amended return is filed in its present form because of, and in accordance with, the demand of the revenue agent, Robert O. Deyer, and under the further protest, as claimed by such company, that the amount of net income set forth in this amended return is not the true and correct net income of the company for the year ending December 31st, 1910, under the provisions of section 38, act of Congress approved August 5th, 1909, and it is claimed that no rights are waived by the company because of the filing of this amended return, and that all rights are reserved by the company.

Claim for refund.

"C."

Claim under series 7, No. 14, revised, and series 7, No. 27, supplement No. 1, for taxes improperly paid or refundable under remedial statutes, and for amounts paid for stamps used in error or excess.

U. S. Internal Revenue.

STATE OF NEW YORK,
County of New York, ss:

The Forty-two Broadway Company, a corporation organized and existing under and by virtue of the laws of the State of New York, with a place of business in the city and county of New York,
24 through its president, Lester S. Holmes, appeals to the Commissioner of Internal Revenue for a refund of taxes collected

as hereinafter described, and the said Lester S. Holmes, being duly sworn according to law, deposes and says that the said corporation is a realty company; that upon the amended return of such corporation for the year 1910, filed under protest on or about April 11th, 1911, it was assessed an internal-revenue tax of one thousand seven hundred eighty-one and 36-100 ($1,781.36) dollars, under section 38 of the act of Congress approved August 5th, 1909, generally known as the corporation income tax law, which amount the said corporation afterwards, on or about the 29th day of April, A. D. 1911, paid under protest to Charles W. Anderson, esq., collector of internal revenue for the second district of New York, and which amount, as the said corporation and this deponent verily believe, should be refunded for the following reasons, viz:

The company was organized chiefly for the purpose of acquiring land and constructing an office building thereon in the city of New York, the capital stock of which company was originally and has always been only $600. The funds from which to acquire such land and construct and operate such office building were obtained, with the exception of the $600 capital stock above referred to, entirely through loans made to such company. Since its organization in April, 1902, such company has been operated at all times at a loss. The allowance, therefore, of only 6 per cent on the capital stock of $600, to wit, $36.00, as a deduction from the gross amount of income of the company resulted in the assessment and the imposition of a tax on such assessment against a company which has really had no net income and whose ordinary and necessary expenses of maintenance and operation of its business and properties included interest actually paid and accruing on a first mortgage, a second mortgage, and other indebtedness, without which mortgages and indebtedness the company could not have maintained and operated its business and properties. The ruling of the Commissioner of Internal Revenue that interest on mortgages of a company of the character of the Forty-two Broadway Company could not be deducted from income, in case such mortgages secured bonds of the company, results in a great hardship to this company and the inequity of such ruling is apparent when it is remembered that the transfer by the company of its real estate, which constitutes the chief portion of its assets, to another company, subject to such mortgages, would have resulted in the levying of no assessment against the Forty-two Broadway Company under section 38 of the act of Congress of August 5th, 1909, and would have permitted the company to which such property had been transferred to deduct the interest on such mortgages from its gross income. The failure of the company to adopt the course above suggested, whether such failure was due to the inconvenience of adopting such course or otherwise, should not, it is respectfully submitted, result in the assessment and imposition of a tax against the company.

In the gross income of $306,817.21, reported in accordance with the demand of Revenue Agent Robert E. Deyer, Esq., there is

included interest from September 30th, 1910, on certain items, which interest was credited to the company on the closing statement for the purpose of adjustment, at the time that the real estate of the company was transferred and sold, on December 30th, 1910, such closing being as of September 30th, 1910, and such interest amounting to $17,379.13.

26 It is claimed on behalf of The Forty-two Broadway Company that such item of $17,379.13 does not and should not constitute income; that the same is in fact a part of the purchase price of the real estate of the company and figured as interest for the purpose of arriving at the amount to be paid for the property by the purchaser; that such item should be deducted from the income of $306,817.21 reported; and The Forty-two Broadway Company claims that the gross income for the purpose of this report should be and is $289,438.08.

In answer to question 4 of such amended return, being ordinary and necessary expenses of maintenance and operation of the business of the company, there is included, in accordance with the demand of the said revenue agent, only the direct cost of operating the building of the company, legal services, officers' salaries, and the commission paid for the sale of the real estate of the company.

The company further claims, however, as a part of the expenses of maintenance and operation of the business and property of the corporation, that there should be included in the answer to question No. 4 of such amended return the following:

Interest on first mortgage, a lien on real property of company, securing bond of company, accrued and paid in 1910	135,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued and paid in 1910	25,000.00
Interest on second mortgage, a lien on real property of company, securing bond of company, accrued prior to 1910, but paid in 1910	76,527.77
27 Other interest on bonded and other indebtedness of the company, contracted in the maintenance and operation of the business and properties of the company, such interest being a liability incurred or paid as a necessary expense in the maintenance of the business and properties of the company. Total of such interest accrued in 1910, $94,215.16; of this amount there was paid in 1910	47,715.16
Total of such interest accrued prior to 1910, but paid in 1910	55,274.00
Total	339,516.93

The Forty-two Broadway Company claims that the answer to question No. 4, for the purpose of such amended return, should be the amount reported, $123,645.46, plus the above interest items amounting to $339,516.93, making a total of $463,162.39.

In answering question No. 7 the amount is left blank in accordance with the demand of the said revenue agent. It is claimed, however, that the amount of taxes on the real estate of the company for the year 1910 should be apportioned for the period from January 1st, 1910, to September 30th, 1910, the date as of which such real estate was transferred, and that the amount of $48,122.51 should be allowed as a deduction.

The contract for sale under which such real estate was transferred was executed April 8th, 1910, and provided for closing on July 30th, 1910. The closing date under such contract was, however, from time to time adjourned, until the final closing was set for and occurred on December 30th, 1910, but such closing was as of September 30th, 1910.

28 The taxes for the year 1910 became a lien on the property of the company on the second Monday of October, 1910. The contract for the sale of the property of the company provided that the amount of such taxes should be added to the purchase price of the building in case such taxes were paid by the company. The company did pay such taxes, amounting to $65,628.47, in October, 1910, and on the closing of the title of the property the total amount of such taxes was added to the purchase price of the building and in that way repaid to the company by the purchaser. The proportionate amount of such taxes from January 1st, 1910, to September 30th, 1910, is $48,122.51.

The above statement and claim is based upon payments actually made during the year 1910. In case it should be ruled or held that such statement and claim should be upon the basis of accruals, changes in the above should be made accordingly.

The accruals above mentioned were regularly entered on the books of The Forty-two Broadway Company for the respective periods referred to.

And the said corporation and this deponent now claim that, by reason of the payment of the said sum of one thousand seven hundred eighty-one and 36-100 ($1,781.36) dollars, the said corporation is justly entitled to have the sum of one thousand seven hundred eighty-one and 36-100 ($1,781.36) dollars, with interest thereon, refunded, and the said corporation and deponent now ask and demand the same.

And this deponent further makes oath that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented for the refunding

29 of the above amount or any part thereof. A claim for abatements has been rejected.

THE FORTY-TWO BROADWAY CO.,
By LESTER S. HOLMES, *President.*
LESTER S. HOLMES,
As President of The Forty-two Broadway Company.

Sworn to and subscribed before me this 15th day of April, A. D. 1912.

[SEAL.] CHRISTINA SPRUNG,
Notary Public, Kings County, No. 18.

Certificate filed in New York County No. 29.
Reg. No. Kings 4862—Reg. No. N. Y. 4155.
(Filed November 8th, 1912.)

30

Answer.

United States District Court,

For the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

The defendant above named by Henry A. Wise, United States attorney for the Southern District of New York, his attorney, for his answer to the complaint herein alleges:

I. He admits the truth of the allegations contained in Paragr'phs I, II, III, and VIII of the complaint herein.

II. He denies the truth of the allegations contained in Paragraphs IV of the complaint herein, except that he admits that the plaintiff on or about February 27, 1911, filed a return under the corporation tax law which purported to show its net income for the year ending December 31, 1910, the original or a certified copy of which will be produced upon the trial hereof for more specific reference to its contents.

31 III. He denies the truth of the allegations contained in Paragraph V of the complaint herein, except that he admits that on or about the 10th day of April, 1911, the plaintiff filed an amended return under the corporation tax law purporting to show its net income for the year ending December 31, 1910, the original or a certified copy of which will be produced upon the trial hereof for more specific reference to its contents.

IV. He denies the truth of the allegations contained in paragraph VI of the complaint herein, except that he admits that on or about the 29th day of April, 1911, there was paid to him the sum of seventeen hundred and eighty-one dollars and thirty-six cents.

V. He denies the truth of the allegations contained in paragraph VII of the complaint herein, except that he admits that on or about the 15th day of April, 1912, the plaintiff appealed to the Commissioner of Internal Revenue for a refund of the said sum of seventeen hundred and eighty-one dollars and thirty-six cents, paid to him on or about the 29th day of April, 1911, the original or a certified copy of which appeal for refund will be produced upon the trial hereof for more specific reference to its contents.

VI. He denies the truth of the allegations contained in paragraph IX of the complaint herein.

VII. He denies any knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs X, XI, XII, XIII, and XIV of the complaint herein.

32 Wherefore defendant prays that the complaint herein be dismissed with costs and the disbursements of this action.

HENRY A. WISE,
United States Attorney for the Southern District of New York, Attorney for Plaintiff.

Office and post-office address, Room 50, United States Court House and Post Office Building, Borough of Manhattan, city of New York.

STATE OF NEW YORK,
County of New York, Southern District of New York, ss:

Charles W. Anderson, being duly sworn, deposes and says: I am the defendant above named; I have read the foregoing answer and know the contents thereof; that the same is true of my own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters I believe it to be true.

CHARLES W. ANDERSON.

Sworn to before me this 26th day of December, 1912.

[SEAL.] CHARLES T. SMITH, *Notary Public.*

(Filed, December 30th, 1912.)

33 *Stipulation waiving jury.*

United States District Court for the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

It is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that this action shall be tried by the court without a jury, a jury being hereby expressly waived.

Dated, New York, November 11, 1913.

BALDWIN & HUTCHINS,
Attorneys for Plaintiff.

H. SNOWDEN MARSHALL,
Attorney for Defendant.

(Filed, December 3rd, 1913.)

34 *Agreed statement of facts.*

United States District Court for the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

It is hereby stipulated and agreed by and between the attorneys of record for the above-named parties that the following facts are admitted for the purpose of the trial of this action and are all the facts in this action:

I. The plaintiff at all the times hereinafter mentioned was and now is a corporation organized in the year 1902, and existing under and by virtue of the laws of the State of New York; a copy of its certificate of incorporation is hereto annexed marked Exhibit 1 and made a part hereof.

II. The defendant at all the times hereinafter mentioned was and now is collector of internal revenue of the United States of America for the Second District of New York.

III. This action arose under a law of the United States
35 providing for internal revenue, being section 38 of the act of Congress approved August 5th, 1909.

IV. The plaintiff on or about the 27th day of February, 1911, filed with the defendant a return on the form given it by the defendant, which purported to state its net income for the year ending December 31st, 1910, a copy of which return is annexed to the complaint, marked A, and made a part hereof.

V. In or about the month of January, 1911, Robert O. Deyer, esq., an internal revenue agent of the United States, duly authorized thereto, called upon the plaintiff and requested that he be allowed to examine the plaintiff's books. The plaintiff permitted him to examine its books, and, as the result of such examination, and of interviews between the said Deyer and officers of the plaintiff, the plaintiff filed with the defendant on or about the 10th day of April, 1911, an amended return on the form given it by the defendant for that purpose, a copy of which amended return is annexed to the complaint, marked B, and made a part hereof. This amended return was filed by the plaintiff because the said Deyer demanded that it must do so and said that otherwise the Commissioner of Internal Revenue would amend the return himself, and the plaintiff complied with such demand in the fear that it would suffer penalties if it failed to so comply. Thereafter, and on or about the 22nd day of April, 1911, the Commissioner of Internal Revenue assessed against the plaintiff upon the basis of the said amended return a tax, under section 38 of the act of August 5th, 1909, amounting to the sum of $1,781.36. Thereafter, and on or about the 26th day of April, 1911, the de-

36 fendant gave the plaintiff notice of the said assessment and demanded payment thereof, a copy of which notice and demand is hereto annexed, marked Exhibit 2, and made a part hereof.

VI. Thereafter, and on or about the 29th day of April, 1911, the plaintiff paid to the defendant the amount of the said tax, to wit, the sum of $1,781.36 and accompanied the payment with a letter, a copy of which is hereto annexed, marked Exhibit 3, and made a part hereof. Such sum and tax was paid by the plaintiff, in accordance with such notice and demand, and the defendant received the said sum, by virtue of his office as collector, in payment of the tax assessed as aforesaid and gave the plaintiff a receipt, a copy of which is hereto annexed, marked Exhibit 3A, and made a part hereof.

VII. On or about the 15th day of April, 1912, the plaintiff made an appeal and a claim to the Commissioner of Internal Revenue, according to the provisions of law in that regard, and according to the regulations of the Secretary of the Treasury, claiming that the said amount, paid as aforesaid, should be refunded to the plaintiff. A copy of said appeal and claim is annexed to the complaint marked C and made a part hereof. Plaintiff accompanied said appeal with a letter dated April 15th, 1912, a copy of which is hereto annexed, marked Exhibit 4, and made a part hereof, and received in reply thereto a letter from the defendant dated April 18th, 1912, a copy of which is hereto annexed, marked Exhibit 5, and made a part hereof.

VIII. On or about the 5th day of June, 1912, a decision of the said commissioner thereon was had, and the said appeal and claim of the plaintiff was rejected by the said commissioner, a copy
37 of which letter of rejection is hereto annexed, marked Exhibit 6, and made a part hereof.

IX. Thereafter, and on or about the 4th day of November, 1912, the plaintiff brought this action.

X. The plaintiff is, and at all the times herein mentioned has been, a realty corporation, and is, and at all such times has been, engaged in no other business or occupation. The plaintiff was organized for the purpose of acquiring land and constructing an office building theron at No. 42 Broadway, in the city of New York, and has at no time transacted any other business. The capital stock of the plaintiff was originally, and has always been, only $600; the funds with which it acquired such land and constructed and operated such office building were obtained, with the exception of the $600 capital stock above referred to, entirely through loans made to the plaintiff; since its organization in April, 1902, the plaintiff has been operated at all times at a loss and has had or earned no net income, and during the year ending December 31st, 1910, had or earned no net income, if interest on its bonded and other indebtedness is to be figured as an expense of operation. Since its organization in 1902, the income and receipts of the plaintiff from the office building aforesaid did not in any year exceed the expenses of conducting said office building, interest on the mortgages on the said property, taxes on the said property, insurance on the said property, and other usual expenses.

XI. During the year ending December 31st, 1910, the plaintiff paid interest on its bonds, secured by first and second mort-
38 gages on the said property, such bonds being in amount the sum of $3,000,000 and $1,500,000, respectively, and also paid interest on other indebtedness of the plaintiff, represented by debentures and notes of the plaintiff, as follows:

Interest on first mortgage, a lien on real property of company securing bond of company, accrued and paid in 1910		$135,000.00
Interest on second mortgage, a lien on real property of company securing bonds of company, accrued and paid in 1910		25,000.00
Interest on second mortgage, a lien on real property of company securing bonds of company, accrued prior to 1910, but paid in 1910		76,527.77
(Other interest on other indebtedness of the company contracted in the maintenance and operation of the business and properties of the company.)		
Total of such interest accrued in 1910	$94,215.16	
Of this amount there was paid in 1910		47,715.16
Total of such interest accrued prior to 1910, but paid in 1910		55,274.00
Total		$339,516.93

Such interest was paid out of income, in accordance with the provisions of the mortgages, debentures, and notes upon which such interest was due, and the rates of such interest were those ordinarily paid on mortgages, debentures, and notes issued in the course of the business of a realty corporation such as that of the plaintiff. If such interest had not been paid, the said mortgages, debentures, and notes would by their terms have fallen due and the plaintiff would
39 have been subject to foreclosure of the said mortgages and suit on the said debentures and notes, and if the said mortgages had been foreclosed the plaintiff would have lost its property, and if suits had been brought on the said debentures and notes and judgments obtained therein the plaintiff's property would have been subject to levy and sale under executions thereon.

XII. Such interest actually accrued and was actually paid by the plaintiff in connection with its business.

XIII. Such interest, except to the extent of $36.00, was not allowed by the said commissioner and the said revenue agent and this defendant; such interest in the original return of the plaintiff was included in item 4 under Deductions as a part of the ordinary and necessary expenses of the maintenance and operation of the business and properties of the plaintiff, but upon the demand of the said revenue agent, the plaintiff omitted such interest in its amended return as a part of the ordinary and necessary expenses of the maintenance and operation of the business and properties of the plaintiff, although claiming in such amended return that such interest should be so included, and such omission was made as above set forth.

XIV. If all such interest should have been properly allowed and included in and as a part of the ordinary and necessary expenses of the maintenance and operation of the business and properties of the plaintiff, then the plaintiff had no net income upon which a tax,

under the said corporation tax law, could or should have been assessed or levied for the period above mentioned, or if only
40 a part of such interest should have been so allowed, then the amount of net income on which a tax should have been levied should be reduced by such amount so allowed, and the tax, if any, which should have been levied against the plaintiff herein should be reduced accordingly.

XV. If the court finds that all or any part of such interest should have been allowed it as a deduction, then the plaintiff shall be entitled to a judgment herein amounting to one per cent of such sums as shall be allowed to the plaintiff in this action, with interest from April 29th, 1911, such judgment, however, not to exceed the sum of $1781.36, with interest, such sum being the amount paid by the plaintiff to the defendant as a tax for the year ending December 31st, 1910.

XVI. At the time of its organization the plaintiff entered into an agreement with the George A. Fuller Company, a copy of which is hereto annexed, marked Exhibit 7 and made a part hereof. The mortgage of $1,150,000, referred to in such agreement, was placed upon the property of the plaintiff, known as 42 Broadway, in the borough of Manhattan, city of New York, and subsequently the second mortgage for $3,250,000, referred to in such agreement, was placed upon such property, and subsequently a second mortgage for $1,500,000 was placed upon the said property, all such mortgages being secured by the bonds of the plaintiff, and being placed in accordance with the plans and arrangements of the plaintiff and its incorporators, made just prior to and at the time of its incorporation in order to carry out this enterprise. Subsequently, and at various times, various moneys were borrowed by the plaintiff, secured by its obligations, known as debentures and notes, and the
41 proceeds of such mortgages and such debentures and notes were necessary for the plaintiff to carry on its business, and to purchase its property, known as 42 Broadway, and to erect an office building on such property, and to operate the same.

XVII. The plans and arrangements above set forth were customarily followed and adopted by realty companies in New York City at the times in question. The interest above referred to is an ordinary and usual expense to realty corporations of the character of the plaintiff, but by the use of these words, "ordinary" and "necessary," the defendant does not admit that payment of such interest is an ordinary and necessary expense actually paid out of income in maintenance and operation of plaintiff's business and properties within the meaning of the statute.

Dated New York, November 11th, 1913.

BALDWIN & HUTCHINS,
Attorneys for Plaintiff.

H. SNOWDEN MARSHALL,
United States District Attorney, Attorney for Defendant.

Exhibit 1.

Certificate of Incorporation of The Forty-two Broadway Company.

We, the undersigned, all being natural persons of full age and at least two-thirds being citizens of the United States, and at least one of us a resident of the State of New York, desiring to form a
42 stock corporation pursuant to the provisions of the business corporation law of the State of New York, do hereby make, sign, acknowledge, and file this certificate for that purpose.

First. The name of the proposed corporation is "The Forty-two Broadway Company."

Second. The purposes for which it is to be formed are to acquire by grant, gift, purchase, devise, or bequest, to buy, own, sell, lease, let, mortgage, dispose of, deal in, and operate generally in real and personal property; to engage in the construction and erection of buildings and other improvements on real estate; to make contracts in connection with the acquiring, buying, owning, selling, leasing, letting, mortgaging, disposing of, dealing in, and operating and improving real and personal property and buildings, erections and improvements on or to be constructed on real property; to acquire, buy, own, sell, dispose of, deal in, and complete contracts and agreements relating to or connected with real and personal property and buildings, erections, and improvements on such real property; and to assume and take over the performance of contracts or agreements of any kind, nature, and description relating to real and personal property made and entered into by others; to negotiate and make, either as principal, agent, or broker, contracts and other agreements relating to the making, taking, and placing of building and other loans in connection with real and personal property and in connection with improvements on or to be placed on such property, and generally to do and perform every act, deed, or thing necessary or proper to be done and performed to carry out or promote the purposes and objects above specified, it being hereby expressly provided that the foregoing enumeration of purposes
43 shall not be held or considered to limit or restrict in any manner the powers of the corporation.

Third. The amount of the capital stock is six hundred dollars ($600.00).

Fourth. The number of shares of which the capital stock shall consist is six (6), and the amount of capital stock with which said corporation will begin business is six hundred dollars ($600.00).

Fifth. Its principal business office is to be located at Great River, in the county of Suffolk, State of New York.

Sixth. Its duration shall be perpetual.

Seventh. The number of its directors is to be three (3).

Eighth. The names and post-office addresses of the directors for the first year are as follows:

Names.	Addresses.
Stanley H. Gardyne Stewart,	56 West 51st Street, Borough of Manhattan, New York City.
Roger S. Baldwin,	322 Lexington Avenue, Borough of Manhattan, New York City.
William P. Jeffery,	142 Columbia Heights, Borough of Brooklyn, New York City.

Ninth. The names and post-office addresses of the subscribers and a statement of the number of shares of stock which each agrees to take in the corporation are as folows:

Names.	Addresses.	No. of shares.
Stanley H. Gardyne Stewart,	56 West 51st Street, Borough of Manhattan, New York City.	4
" Roger S. Baldwin,	322 Lexington Avenue, Borough of Manhattan, New City.	1
William P. Jeffery,	142 Columbia Heights, Borough of Brooklyn, New York City.	1

In witness whereof we have made, signed, acknowledged, and filed this certificate in duplicate.

Dated this 5th day of April, 1902.

STANLEY H. GARDYNE STEWART.
ROGER S. BALDWIN.
WILLIAM P. JEFFERY.

STATE OF NEW YORK,
County of New York, ss:

On this 5th day of April, 1902, before me personally came Stanley H. Gardyne Stewart, Roger S. Baldwin, and William P. Jeffery, to me personally known and known to me to be the persons described in and who made and signed the foregoing certificate and severally duly acknowledged to me that they had made, signed, and executed the same for the uses and purposes therein set forth.

HARRISON W. MACLENATHEN,
Com. of Deeds, City of New York.

45 *Exhibit 2.*

17.—Revised July, 1899.

Notice of and Demand for Taxes Assessed.

UNITED STATES INTERNAL REVENUE,
OFFICE OF THE COLLECTOR OF INTERNAL REVENUE,
2ND DISTRICT, STATE OF NEW YORK, *Apr. 26th, 1911.*

List for month of Feb. 1911, Div.

M 42 BROADWAY CO.,
27 Pine St.:

You are hereby notified that a tax, under the internal revenue laws of the United States, amounting to seventeen hundred and eighty-one & 36/100 dollars the same being a tax upon net income, has been assessed against you by the Commissioner of Internal Revenue, and transmitted by him to me for collection. Demand is hereby made for this tax. This tax is due and payable on or before the May 6th, and unless paid within ten days after this notice and demand it will become my duty to collect the same with a penalty of five per centum additional and interest at one per centum per month.

Payment may be made to me at U. S. Custom House Bldg.

CHAS. W. ANDERSON.

$1781.36/100

Bring this notice with you.

46 *Exhibit 3.*

APRIL 28TH, 1911.

CHARLES W. ANDERSON, Esq.,
Collector United States Internal Revenue,
United States Custom House Bldg., New York City.

DEAR SIR: Please find enclosed our certified check for $1781.36 payable to your order as collector of United States Customs, such check being in payment of assessment against us by the Commissioner of Internal Revenue, in accordance with your notice of the 26th instant, which we presume to be for the year 1910, such check and payment of assessment being forwarded to you under protest, without prejudice to any of our rights. In this connection we draw your attention to the protests contained in the returns made by us and in the claim for abatement filed by us.

Very truly, yours,

THE FORTY-TWO BROADWAY COMPANY,
By ROGER S. BALDWIN,
Treasurer.

47 *Exhibit 3A.*

United States Internal Revenue, Collector's Office, 2nd District of New York.

APRIL 29, 1911.

Received of Forty-two Broadway Co., 27 Pine, seventeen hundred, eighty-one 36/100 dollars, tax on annual net income ending Dec. 31, 1910 ..... $1,781.36
Five per cent penalty ..... $
Interest, years months ..... $
Paid under protest.
Total $1,781.36

Said amount of tax being assessed on my list for Feb. —, 1911, $1,781.36.

J. B. PETERSON, *Deputy Collector.*

Exhibit 4.

APRIL 15th, 1912.

Hon. CHARLES W. ANDERSON,
Collector, Custom House, borough of Manhattan, New York City.

DEAR SIR: We enclose herewith, on behalf of The Forty-two Broadway Company, a duplicate original of claim for refunding of internal revenue tax for the year 1910 of $1,781.36, purporting to be under section 38 of the act of Congress approved August 5th, 1909, generally known as the corporation income tax law, which amount the said corporation paid under protest on or about April 29th, 1911, to you as collector of internal revenue for the second district of New York.

A duplicate original of the above claim has been forwarded
48 to the Commissioner of Internal Revenue of the United States at Washington, D. C. May we request you to acknowledge receipt of the enclosed claim. We should be pleased to receive any suggestions which you may desire to make with regard to the form of this claim, or with regard to the manner in which the matters raised thereby may be tested in the courts.

Thanking you in advance for your courtesy,

Respectfully yours,

BALDWIN & HUTCHINS.

Exhibit 5.

Treasury Department, Internal Revenue Service, New York, N. Y.

OFFICE OF THE COLLECTOR,
SECOND DISTRICT OF NEW YORK,
CUSTOMHOUSE BUILDING,
New York, N. Y., April 18, 1912.

BALDWIN & HUTCHINS,
27 Pine St., New York, N. Y.

SIRS: I am in receipt of yours of the 15th inst., enclosing claim on behalf of the Forty-two Broadway Company for the refund-

ing of internal revenue tax for the year 1910. I would state that it will be necessary to file with such claim the receipt for the tax in question which was issued from this office. The forwarding of a duplicate claim to Washington was entirely unnecessary, as the claim that was filed here is all that is necessary in such cases.

Respectfully,

CHARLES W. ANDERSON, *Collector.*

49 *Exhibit 6.*

WASHINGTON, *June 5, 1912.*

C. W. ANDERSON, Esq.,
Collector 2d District, New York, N. Y.

SIR: The claim of the Forty-two Broadway Company for the refunding of $1,781.36, special excise tax for 1910, has been examined.

The claimant contends that $17,379.13 was erroneously included in gross income by Revenue Agent Sinsel in reporting the corporation for assessment. It appears, however, that the sum in question was paid by this corporation as interest on indebtedness upon a certain property which was sold by claimant on December 30, 1910. At the time of the sale the purchaser of the property reimbursed claimant for this interest, and therefore this payment was actually received into claimant's income during 1910. Since, however, claimant's capital stock outstanding at the close of the year was but $600, claimant is entitled to deduct from gross income only $36 of this total expenditure, and the balance was properly included by the revenue agent in net income and tax was legally collected because of this inclusion.

The claimant further contends that other interest, aggregating $339,516.93, paid on indebtedness should be deducted from gross income. Of this total, however, it appears that $55,274.00 was interest due and payable prior to 1910 and which is not, therefore, a legitimate charge against income of 1910. All the balance was interest upon the indebtedness of the corporation, and since it was all paid upon indebtedness which exceeded the amount of capital stock outstanding at the close of the year, none of it can be legally deducted.

50 It is also claimed that there should be deducted from gross income taxes amounting to $65,628.47, paid by claimant in October, 1910. When, however, the above-mentioned sale of property was made, claimant was reimbursed by the purchaser for this tax expenditure. The revenue agent did not include this receipt of income by claimant in claimant's gross income, and therefore did not permit the deduction from gross income because of the taxes. If any part of this tax payment were to be deducted from gross income, it would be necessary to include in gross income the whole amount by which claimant was reimbursed, and therefore no part of the tax that has been paid would be refundable on this account.

The claim is hereby rejected. Please notify the claimant of this action, returning the receipt on Form 1 herein enclosed.

Respectfully,

R. E. CABELL,
Commissioner.

(Filed, December 3rd, 1913.)

51 *Exhibit 7.*

Agreement made this 12th day of April, 1902, between the George A. Fuller Company, hereinafter referred to as "contrator," a corporation incorporated under the laws of the State of New Jersey, and The Forty-two Broadway Company, hereinafter referred to as "owner," a corporation organized under the laws of the State of New York.

Whereas the owner is or is about to become the owner of the premises now known as Nos. 36, 38, 40, and 42 Broadway, extending through to New Street, in the city of New York, subject to a mortgage for one million one hundred & fifty thousand dollars, bearing interest at the rate of four and one-half per cent and payable about one year from date, with privilege of prepayment on sixty days' notice, and desires to arrange for the erection of an office building thereon.

Now, therefore, this indenture witnesseth, that the contractor agrees to wreck and remove the present buildings from said site, do the necessary excavation, and erect on said plot a modern steel frame fireproof office building in accordance with the provisions of schedule "A" hereto annexed, and that it will perform said work and deliver said building ready for occupancy within twelve months after possession of said premises shall be given to it for the sum of two million two hundred and fifty thousand dollars, payable as follows: The owner shall on the first day of each month cause the architect to prepare and deliver to the contractor a certificate showing proportionate amount of labor then performed and materials then installed, and the amount due the contractor based on such estimate. The owner will then from the proceeds of the loan hereinafter mentioned, on demand, pay to the contractor ninety per
52 cent of the amount so certified and make the final payment, including the balances retained out of each certificate, when the building is ready for occupancy.

The owner hereby covenants and agrees with the contractor that in consideration of the erection of said building as aforesaid the owned will pay the contractor the said sum of two million two hundred & fifty thousand dollars in the manner herein provided.

And it is mutually understood and agreed—

1. That the owner shall cause the complete plans and specifications to be prepared by the architect and delivered to the contractor on or before May the twentieth, nineteen hundred & two, and that within

thirty days after the submission of said plans to the contractor they shall be approved by the contractor or objections made to them in writing, definitely specifying such objections. When approved they shall be signed by the owner and contractor and when signed shall become a part of this contract and shall supersede and take the place of all provisions herein relating to the architectural design and the nature and character of the plan, in accordance with which the building herein provided for is to be erected.

2. That the building during construction shall be insured against damage by fire by the contractor, at the expense of the owner, in an amount satisfactory to the contractor, but which shall not exceed the fair value of the building as it progresses, as certified by the architect. The loss shall be payable to the parties hereto as their interests may appear.

3. That all the work is to be performed under the supervision of the architect, and the architect and owner and its representa-
53 tives shall at all times be permitted to examine and inspect the same.

4. The building, when completed, shall be turned over by the contractor free and clear from all liens, indebtedness, and building department and fire department violations incurred by the contractor in its construction. If after the completion of said building any liens or violations of any nature or description for which the contractor is responsible shall be filed or shall remain of record, the contractor will on demand cause the same to be immediately bonded or otherwise removed of record.

5. The time within which the contractor is to carry out this contract shall be equitably extended if the contractor be delayed by any neglect on the part of the owner or achitect, or by damage by fire, lightning, earthquake, or cyclone, or the abandonment of work, by employees, through no default on the part of the contractor, and shall within seven days after the commencement of the delay claimed because of the occurrence of any of the events above referred to serve a notice in writing upon the owner stating the cause of the delay, and shall after the removal of said cause serve a notice in writing upon the owner within seven days of the removal stating the extension claimed by reason of such occurrences.

6. The contractor shall indemnify and hold the owner harmless against all claims for damages to persons and corporations and to adjoining property in carrying out the work called for by this contract.

7. The owner agrees to pay promptly during construction all taxes, water rates, assessments, interest on mortgages, architect's fees, premiums on insurance as above provided and vault per-
54 mits, if any, and also the extra cost of any work which it may ask the contractor to perform incidental to changes rendered necessary for the installation of tenants.

The contractor agrees that it will either loan or cause to be loaned to the owner the sum of three million two hundred and fifty thou-

sand dollars, to be secured by a bond of the owner, duly executed and acknowledged, conditioned for its payment five years from its date, with interest at the rate of four and one-half per cent per annum on one million one hundred & fifty thousand dollars and on the balance at the rate of five per cent per annum until the completion of the building, and thereafter at the rate of four and one-half per cent on the entire mortgage indebtedness, payable semiannually, the said bond to be secured by not more than one mortgage duly executed and acknowledged so as to be a valid first lien upon said premises and the building to be erected and its appurtenances, said mortgage to contain the usual tax, interest, assessment, insurance and receiver's clauses, and what is known as the special-tax clause, and also such other clauses as the counsel for the contractor may deem proper, provided the same are usual and customary, with the same provisions as to interest as are contained in the bond. The mortgage of three million two hundred & fifty thousand dollars is to contain an agreement on the part of the owner that at any time upon demand the owner will execute in place of said mortgage a new mortgage, either to the contractor or to a person or corporation to be designated by the contractor, providing such new mortgage does not exceed three million two hundred and fifty thousand dollars in amount and is not more burdensome in terms than the mortgage above provided for.

The loan herein provided for is to be advanced as follows:

An amount sufficient to pay off the principal of the mortgage of one million one hundred and fifty thousand dollars to be placed on the land when the owner takes title shall be advanced and applied to the payment of said mortgage and the mortgage satisfied of record, at any time after three months, within seventy days after a demand made by the owner, the owner paying the accrued interest to said date. The balance of the loan shall be advanced to the owner at the times and in the manner required to enable it to meet the payments hereinbefore set forth due to the contractor under this contract, for which payments the owner shall not be liable until such advances have been made by the contractor or by the person or corporation which it causes to make such loan, unless such advances be not made for a valid cause arising out of the act or default of the owner. The balance of one hundred and fifty thousand dollars which the owner will be compelled to pay in addition to the amount obtained from the loan is to be paid by the owner from funds not the proceeds of the mortgage, upon five days' notice in writing, as follows:

Fifty thousand dollars when foundations are all in.

Fifty thousand dollars when ten stories of steel are set, and fifty thousand dollars when all of the steel is up, said payments to be made upon the certificate of the architect.

The owner further agrees that it will, if requested, execute and deliver a building loan agreement in the form annexed to this contract, made a part hereof and marked "B," in reference

56 to said mortgage, and that it will not until said mortgage has been fully advanced sell or convey any interest in said land, or encumber the same in any manner, provided, however, that the owner shall have a right at any time to place a mortgage upon the said premises, including the building and its appurtenances, which shall be subject, however, to a first mortgage of three million two hundred and fifty thousand dollars or any renewal or substitution thereof. The said second mortgage shall contain a clause satisfactory to the counsel of the contractor to the effect that said second mortgage shall be subject to the said first mortgage of the above amount and any renewals or substitutions therefor.

It is further mutually understood and agreed that if the contractor fail to have said building substantially completed so as to be ready for tenants within the time aforesaid, the damages against the contractor shall be an amount equal to the interest on the then existing first mortgage, taxes, assessments, and water rates and fire insurance, apportioned so as to cover the period from the date fixed for such completion until said building shall be substantially complete and ready for tenants, which said damages the contractor agrees to pay the owner on demand.

If the loan of three million two hundred and fifty thousand dollars be made by some person other than the contractor, the right to receive the advances shall be assigned to the contractor, and advances so assigned shall be applied to the payments called for in this contract. If the mortgage be made to the contractor, it shall, if the contractor so requests, contain a clause to the effect that the payments under this contract as they severally mature shall be deemed advances upon said mortgage and secured by said mortgage.

57 The owner shall give to the contractor with the mortgage for three million two hundred & fifty thousand dollars a policy of title insurance of the Lawyers' Title Insurance Co., insuring the mortgage to be a valid lien on the premises, but the contractor shall not, however, have a right to ask for insurance in an amount which will exceed the amount advanced at the time.

The owner agrees that it will deliver possession of said premises to the contractor so that it can commence work on or before June 1, 1903.

The contractor will, if requested by the owner, alter or change the partitions in the several stories, even after the plans have been agreed upon, if the owner request such change in writing within nine months after work shall be commenced. The owner shall in this event be credited with the work and material omitted and charged with the cost, and pay the contractor the extra cost, if any.

The contractor shall at the time of the delivery of the $3,250,000 bond and mortgage execute and deliver to the owner an agreement to the effect that on the due date of said mortgage or on a date within thirty days thereafter, specified by the owner, it will, if requested by the owner, by notice given at least three months in advance, do one of the following things:

1st. If the contractor be the owner of said bond and mortgage it will execute an agreement with the owner extending the time of payment of the principal for five years on the same terms.

2nd. If the contractor be not the owner of said bond and mortgage, it will take an assignment of said bond and mortgage, if tendered to it, and execute a like extension agreement, or it will loan or cause to be loaned to the owner the amount of $3,000,000
58 upon bond and mortgage in similar terms, except payable at a date five years later, in which event the mortgage for $3,250,000 shall be paid off and satisfied of record.

Provided, however, that the contractor shall not be called upon to do any of the above things in regard to said mortgage unless the principal of said mortgage debt shall have been reduced to $3,000,000 and all accrued interest, taxes, assessments, and water rates shall have been paid, and provided also said extension agreements shall be drawn by the Lawyers' Title Insurance Company and approved by it and shall not affect the priority of said mortgage and, in the event of a new bond and mortgage being given, that they be accompanied by a policy of the Lawyers' Title Insurance Company or the Title Guarantee & Trust Company, insuring it to be a valid first lien on said premises.

And provided further, that the owner shall have carried out the provisions of the agreement and bond and mortgage herein provided for so far as the same are to be performed by it.

In witness whereof the parties hereto have caused their corporate seals to be hereunto affixed and these presents to be signed by their respective officers the day and year first above written.

[SEAL.] GEORGE A. FULLER CO.,
By S. P. McCONNELL,
Vice President.

Attest:
R. G. BABBAGE,
Secretary.

[SEAL.] THE FORTY-TWO BROADWAY COMPANY,
By STANLEY H. GARDYNE STEWART,
President.

Attest:
ROGER S. BALDWIN,
Secretary.

59 STATE OF NEW YORK,
County of New York, ss:

On the twelfth day of April, in the year one thousand nine hundred and two, before me personally came S. P. McConnell, to me known, who being by me duly sworn, did depose and say that he resided in the city of New York; that he is the vice president of the George A. Fuller Company, the corporation described in and which executed the foregoing instrument; that he knew the seal of said corporation; that the seal affixed to said instrument was such

corporate seal; that it was so affixed by order of the board of directors of said corporation; and that he signed his name thereto by like order.

D. W. LANMAN,
Notary Public, King's County.

Certificate filed in New York County.

STATE OF NEW YORK,
County of New York, ss:

On the twelfth day of April, in the year one thousand nine hundred and two, before me personally came Stanley H. Gardyne Stewart, to me known, who, being by me duly sworn, did depose and say that he resided in the city of New York; that he is the president of The Forty-two Broadway Company, the corporation described in and which executed the foregoing instrument; that he knew the seal of said corporation; that the seal affixed to said instrument was such corporate seal; that it was so affixed by order of the board of directors of said corporation; and that he signed his name thereto by like order.

D. W. LANMAN,
Notary Public, King's County.

Certificate filed in New York County.

60 Schedule "A."

Description of Building.

A modern steel frame fireproof office building, built in accordance with plans and specifications to be prepared therefor by Henry Ives Cobb, architect, the said plans and specifications to call for a building twenty stories and basement in height, with a sub-basement on the New Street side covering about half the area of the plot, similar in general construction and finish to the building being erected at the southeast corner of Maiden Lane and Broadway, except that said plans shall provide that the height of stories from floor to floor will be as follows: Sub-basement twelve feet, basement thirteen feet, first floor nineteen feet six inches, second story fifteen feet six inches, and typical stories eleven feet four inches; said building shall have the usual attic space, in height to be six feet from ceiling of top story to highest point of roof; the Broadway front will have granite base to level of first-story sills, with limestone for three lower stories and pressed brick and terra cotta for the stories above, but shall not be more expensive in character and finish than the street fronts of the building above referred to; the New Street front shall have granite base with three lower stories of limestone and pressed brick and terra cotta in the stories above; there will be twelve hydraulic elevators; the basement, first and second stories will be left practically in large rooms and plain plastered only; the dividing of the

typical stories as to partitions, doors, windows, etc., the amount of lighting, and the number of plumbing fixtures shall not be greater in proportion to the area covered than in the building above referred to; the character of the corridors as to marble work, the char-
61 acter of the ornamental iron, painting, roofing and sheet metal, the marble and terrazzo work in general, plumbing, electric wiring, electric plant, heating plant and boilers, hardware and lighting fixtures shall not be more expensive in proportion that in said building above referred to; the steel shall be designed to carry the loads called for by law and shall be made acceptable to the building department of the city of New York and shall be carried out on lines dictated by the contractor to accomplish this, and in all typical floors the general arrangement of elevators, toilet rooms, doors, and corridors in front of the elevators shall be substantially as shown on the preliminary sketch heretofore submitted to the contractor. Partitions and divisions of offices shall be carried out as above called for, not greater in proportion to the area covered than in the building being erected at the southeast corner of Maiden Lane and Broadway, but three of the typical floors shall each be finished as four

Schedule "B."

Agreement made this day of , 1902, between hereinafter referred to as the applicant, and

Whereas the applicant has applied to said company for a loan of $, to be evidenced by bond conditioned for the repayment of the amount advanced, on the day of , 190 , and interest thereon at the rate of per cent per annum, payable semiannually, secured by a mortgage on the premises, , upon which the applicant is to erect , duly executed and acknowl-
62 edged by all persons necessary to make it a valid lien on said premises, of such a nature as the company is willing to accept, the said bond and mortgage to be in form approved by the company, and the said loan to be advanced as follows:

Now therefore, the company hereby accepts said application and agrees to make said loan, and the applicant agrees to take it, upon the following terms and conditions:

First. The company may advance parts or the whole of any installments before they become due, if it believes it advisable so to do, and all such advances or payments shall be deemed to have been made in pursuance of this agreement.

Second. The company may cause said loan to be made by some other corporation or person. The bond and mortgage shall then run to said corporation or person. The provisions of this agreement shall apply to such bond and mortgage; and if the loan be so made, it shall be deemed a compliance by the company with this agreement. The company may assign said bond and mortgage and cause the assignee to make any advances not made at the time of the assignment, and all the provisions of this agreement shall continue to apply to said loan and bond and mortgage as if they had not been assigned.

Third. The company or any holder of said bond and mortgage may require the owner of the premises to execute a new mortgage in the place of the mortgage above provided for, either to it or to some other person or corporation, and such new mortgage, which shall not be more burdensome in its terms than the mortgage herein provided for, so granted shall be deemed made in pursuance of this agreement and not to be a modification thereof.

Fourth. In either of the following events all obligation on
63 the part of the company to make said loan or to make any further advances shall, if it so elect, cease and terminate, but the company may make advances without becoming liable to make any other advances.

1. If the mortgage offered by the applicant shall not give to the company a lien for the indebtedness to be secured thereby on the premises above set forth, satisfactory to the Lawyers' Title Insurance Company.

2. If the loan is to be advanced in more than one payment, and any payment called for, and the title company shall not approve of the payment called for because of some act, encumbrance, or question arising after the making of the preceding payment.

3. If the applicant assign this contract or said advances or any interest therein, or if said premises be conveyed or encumbered in any way without the consent of the company, except that the applicant shall have the right at any time to place a mortgage upon said premises, including the building and its appurtenances, which shall be subject to the said mortgage of $3,250,000 and to the amount of all advances made or thereafter to be made thereon, and to any mortgage given in renewal or substitution therefor, provided said second mortgage shall contain a clause satisfactory to the counsel of the George A. Fuller Company to the effect that said second mortgage shall be subject to the first mortgage and any renewals thereof, as above provided.

4. If the improvements on said premises be materially injured or destroyed by fire or otherwise.

5. If the makers of said bond and mortgage shall fail to comply with any of the covenants therein contained.

In witness whereof, the applicant has hereunto set
64 hand and seal, and the company has caused these presents to be signed by two of its officers and its corporate seal to be hereunto affixed, the day and year first above written.

(Endorsed.)

Oct. 15/02.

Received from Forty-two Broadway Company the sum of seventy-five thousand dollars on account of within contract on certificate No. 4909 of Henry Ives Cobb.

George A. Fuller Co.,
By R. G. Babbage,
Secretary.

Nov. 21/02.

Received the further sum of $75,000 on certificate No. 4914.

George A. Fuller Co.,
R. G. Babbage,
Secretary.

Dec. 17/02.

Received the further sum of $50,000 on certificate No. 4915.

George A. Fuller Co.,
R. G. Babbage,
Secretary.

Mch. 20, 1903.

No. 4924. Received the further sum of $50,000 on certificate.

George A. Fuller Co.,
By Stillman Gray.

Apl. 16, 1903.

Received the further sum of $150,000 on certificate No. 4884.

George A. Fuller Co.,
By Stillman Gray.

65

May 21, 1903.

Received the further sum of $250,000 on certificate No. 4885.

George A. Fuller Co.,
By Stillman Gray.

June 19, 1903.

Received the further sum of $100,000 on certificate No. 4893.

George A. Fuller Co.,
By Stillman Gray.

July 16, 1903.

Received the further sum of $150,000 on certificate No. 4891.

George A. Fuller Co.,
By Stillman Gray.

Aug. 17, 1903.

Received the further sum of $300,000 on certificate No. 4895.

George A. Fuller Co.,
H. O. Winsor, Jr.

Sept. 16, 1903.

Received the further sum of $180,000.00 on certificate No. 6000.

George A. Fuller Co.,
H. O. Winsor, Jr.

Oct. 20, 1903.

Received the further sum of $132,000.00 on certificate No. 6001.

George A. Fuller Co.,
H. O. Winsor, Jr.

66

Nov. 16, 1903.

Received the further sum of $188,000.00 on certificate No. 6003.

GEORGE A. FULLER CO.,
H. O. WINSOR, Jr.

DEC. 17, 1903.

Received the further sum of $125,000.00 on certificate No. 6011.

GEORGE A. FULLER CO.,
H. O. WINSOR, Jr.

JAN. 19, 1904.

Received the further sum of $275,000.00 on certificate No. 6018.

GEORGE A. FULLER CO.,
H. O. WINSOR, Jr.

MARCH 31, 1904.

Received the further sum of $30,925.00 on certificate No. 6026.

GEORGE A. FULLER CO.,
By B. M. FELLOWS, *Treas.*

67 *Opinion.*

United States District Court, Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL Revenue of the United States of America for the Second District of New York, defendant.

Baldwin & Hutchins, for plaintiff.

H. Snowden Marshall, United States attorney; Addison S. Pratt, assistant United States attorney, for defendant.

HOLT, J.:

This suit is brought to recover the amount of a tax paid under protest, imposed under section 38 of the act of August 5, 1909 (36 Stat. at L., p. 112), imposing a special excise tax on the income of corporations. The plaintiff, The Forty-two Broadway Company, is a corporation of the class commonly known as realty corporations, organized for the purpose of building and renting a building in the city of New York. Its paid-in capital is $600, and its bonded indebtedness is $4,750,000, secured by mortgages upon its real estate. Its property consists of the premises and the building on them at 42

68 Broadway, New York City. The land was purchased and the building constructed substantially upon borrowed money, to secure the repayment of which bonds were given by the corporation, secured by mortgages on the property.

The act in question imposes a tax upon the net income of corporations. The second paragraph of section 38 provides as follows:

"Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or posession of property. * * *

"(Third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint-stock company or association, or insurance company outstanding at the close of the year, and in the case of a bank, banking association, or trust company all interest actually paid by it within the year on deposits."

In computing the tax due from the plaintiff the assessor deducted from the gross income the amount of interest on $600, the capital stock, but refused to deduct any further amount for interest paid on the bonded indebtedness. If the entire amount paid by the plaintiff, during the year in question, as interest on its bonded indebtedness had been deducted from the gross income, no net income would have existed, and no tax could have been levied. The question in the case therefore is whether, in computing the tax, the entire
69 amount of interest paid on bonded indebtedness should be deducted.

It is obvious that the provision of the statute marked "third," above quoted, is a sufficient authority for the action of the assessor, if the other provisions of the statute and the general purpose of this legislation are not to be considered. The provision marked "third" provides specifically for the amount of interest paid on bonded indebtedness which is to be deducted in ascertaining the net income, and the claim that that provision of the statute is decisive of the case is very weighty. But the object of this statute was to impose a tax upon the net income of corporations. Net income, of course, means gross income after deducting all outgo necessarily incident to the business. The proof in this case shows clearly that the plaintiff had no net income. It was doing business at a loss. A computation of its net income by a method which did not include as an item to be deducted the interest it was paying on its mortgages was an absurdity, and I think that the provision of the statute above quoted marked "third" may be deemed in this case modified by the provisions of the statute marked "first." The interest paid on the mortgages was one of "the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties," and it was a charge "such as rentals or franchise payments, required to be made as a condition to the con-

tinued use or possession of property." If the interest on the mortgages had not been paid, the mortgages would have been foreclosed, the property sold, and the continued use and possession of the property and the entire business of the corporation terminated. Such a
70 corporation as the plaintiff differs radically from most other corporations. The ownership of real estate by a corporation is usually a mere incident to the main business of the corporation, but in such a corporation as the plaintiff the ownership and use of the real estate is usually the sole business of the corporation. In this case the capital stock was only $600, while its bonded indebtedness was nearly $5,000,000. Its sole property was real estate, which it had purchased with money borrowed on mortgage, and its sole business was the renting of such real estate. No method of computing its net income which did not include among the items to be deducted from gross income the amounts paid for interest on its mortgages could bring out a correct result.

The general rule in reference to statutes imposing taxes is that they are to be strictly construed against the Government, and in case of any doubt as to their meaning they are to be given a liberal construction in favor of those subjected to taxation. In view of this general rule, the peculiar character of this corporation, the gross injustice of imposing a tax on this defendant on the ground that it had a net income, when, in fact, it had not, and all the provisions of the statute, my conclusion is, notwithstanding the general rule in respect to the deduction of interest on bonded indebtedness contained in the provision of the statute marked "third," that the tax exacted in this case was unauthorized, and that there should be a decree for the plaintiff.

(Filed December 3, 1913.)

71 *Order for judgment.*

At a stated term of the District Court of the United States for the Southern District of New York held at the court rooms of said court in the post office building, borough of Manhattan, city of New York, on the 11th day of December, 1913.

Present: Hon. George C. Holt, district judge.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of U. S. for Second District of New York, defendant.

The issues in this action having duly come on for trial before me on an agreed statement of facts duly executed and filed herein at a stated term of the United States District Court for the Southern District of New York on the 11th day of November, 1913, without a jury, a jury having been waived in writing by a stipulation of both

of the parties herein, and oral and written argument by both the parties herein having been considered by me, and the issues of this action having been submitted for decision and my opinion in writing herein having been rendered after due consideration on the 3rd day of December, 1913, directing that the plaintiff have judgment
72 upon the merits, now, on motion of Baldwin & Hutchins, attorneys for the plaintiff, it is

Ordered and adjudged, in conformity with said opinion, that the plaintiff have judgment herein for the sum of one thousand seven hundred and eighty-one and 36/100 ($1,781.36) dollars, with interest thereon from the 29th day of April, 1911, together with the costs and disbursements of this action.

GEO. C. HOLT, *D. J.*

Approved as to form:
H. SNOWDEN MARSHALL,
United States Attorney, Attorney for Defendant.
(Filed, December 11th, 1913.)

73 *Judgment.*

District Court of the United States, for the Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
against
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of U. S. for Second District of New York, defendant.

The issues in this action having duly come on for trial before the Hon. George C. Holt, district judge, on an agreed statement of facts duly executed and filed, at a stated term of the United States District Court for the Southern District of New York held at the United States court house in the post office building, in the borough of Manhattan, city, county, and State of New York, on the 11th day of November, 1913, without a jury, a jury having been waived in writing by a stipulation of both parties, and the court after due deliberation having directed judgment for the plaintiff for one thousand seven hundred and eighty-one and 36/100 dollars ($1,781.36), with interest thereon from the 29th day of April, 1911, together with the costs and disbursements of this action, it is

Ordered and adjudged that the plaintiff herein have judgment against the defendant herein for the sum of one thousand seven hun-
74 dred and eighty-one and 36/100 dollars, with interest amounting to two hundred seventy-nine and 54/100 dollars, and costs amounting to forty and 30/100 dollars, a total of $2,101.20.

Judgment signed this 13th day of December, 1913.

ALEX. GILCHRIST, Jr., *Clerk.*

(Filed, December 13th, 1913.)

Assignment of errors.

United States District Court, Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY, PLAINTIFF,
vs.
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

Now comes the defendant, by H. Snowden Marshall, United States Attorney for the Southern District of New York, his attorney, and makes and files the following assignment of errors, which he alleges occurred on the trial of this action and upon which he will rely upon the prosecution of his writ of error:

75 I. The court erred in directing and entering judgment in favor of the plaintiff and against the defendant for the sum of $2,101.20 or for any other amount.

II. The court erred in not directing and entering judgment in favor of the defendant and against the plaintiff, dismissing its complaint upon the merits.

III. The court erred in holding and deciding that under the provisions of section 38 of the act of August 5, 1909, the net income of a corporation subject thereto means gross income after deducting all outgo necessarily incident to its business.

IV. The court erred in holding and deciding that the plaintiff had no net income during the year 1910, within the meaning of section 38 of the act of August 5, 1909.

V. The court erred in holding and deciding that the provisions of subdivision (3rd) in paragraph second of section 38 of the act of August 5, 1909, may be deemed modified by the provisions of subdivision (1st) in the same paragraph, at least in the case at bar.

VI. The court erred in holding and deciding that the interest paid on the mortgages of the plaintiff during the year 1910 was one of "the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties."

VII. The court erred in holding and deciding that the interest paid by the plaintiff on its mortgages during the year 1910
76 was a charge "such as rentals or franchise payments required to be made as a condition to the continued use or possession of property."

VIII. The court erred in holding and deciding that the tax exacted by the defendant of the plaintiff on its net income for the year 1910 under the provisions of section 38 of the act of August 5, 1909, was unauthorized and that no tax could lawfully be exacted from the plaintiff on its net income during the year 1910 under the provisions of said section 38 of the act of August 5, 1909.

And the defendant prays that the judgment aforesaid for the errors aforesaid and for other errors in the record and proceedings herein may be reversed and for naught held and esteemed, and that

he may be restored to all things that he has lost by reason of the said judgment.

Dated December 18th, 1913.

H. SNOWDEN MARSHALL,
United States Attorney for the Southern District of New York, Attorney for Defendant.

Office and post-office address, U. S. Court house and Post Office Building, New York City, N. Y.

(Filed December 18th, 1913.)

77 *Citation.*

By the Honorable George C. Holt, one of the judges of the District Court of the United States for the Southern District of New York in the Second Circuit.

To THE FORTY-TWO BROADWAY COMPANY, *greeting:*

You are hereby cited and admonished to be and appear before a United States Circuit Court of Appeals for the Second Circuit, to be holden at the borough of Manhattan, in the city of New York, in the district and circuit above named, on the 17th day of January, 1914, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the Southern District of New York, wherein Charles W. Anderson, collector of internal revenue of the United States of America for the Second District of New York, is plaintiff in error and you are defendant in error, to show cause, if any there be, why the judgment in said writ of error mentioned should not be corrected and speedy justice should not be done in that behalf.

Given under my hand at the borough of Manhattan, in the city of New York, in the district and circuit above named, this 18th day of December, in the year of our Lord one thousand nine hundred thirteen, and of the independence of the United States the one hundred and thirty-eighth.

GEO. C. HOLT,
Judge of the District Court of the United States for the Southern District of New York, in the Second Circuit.

(Filed December 18, 1913.)

78 *Stipulation as to record.*

United States District Court, Southern District of New York.

THE FORTY-TWO BROADWAY COMPANY,
vs.
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE of the United States of America for the Second District of New York.

It is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that the foregoing printed pages

are a true transcript of the record herein as agreed upon by the parties hereto, and that they may be so certified by the clerk of this court.

Dated New York, January 16th, 1914.

BALDWIN & HUTCHINS,
Attorneys for Plaintiff.

H. SNOWDEN MARSHALL,
Attorney for Defendant.

79 UNITED STATES OF AMERICA,
Southern District of New York, ss:

THE FORTY-TWO BROADWAY COMPANY
vs.
CHARLES W. ANDERSON, COLLECTOR OF INTERNAL revenue of the United States of America for the Second District of New York, defendant.

I, Alexander Gilchrist, jr., clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, this 16th day of January, in the year of our Lord one thousand nine hundred and fourteen, and of the Independence of the said United States the one hundred and thirty-eighth.

ALEX. GILCHRIST, Jr., *Clerk.*

80 United States Circuit Court of Appeals for the Second Circuit.

No. 221—October term, 1913. Argued April 6, 1914. Decided April 28, 1914.

CHARLES W. ANDERSON, AS COLLECTOR, ETC., PLAINTIFF IN error,
vs.
FORTY-TWO BROADWAY COMPANY, DEFENDANT IN ERROR.

In error to the District Court of the United States for the Southern District of New York.

Before Lacombe, Coxe, and Ward, circuit judges.

WARD, Circuit Judge:

The Forty-two Broadway Company is a corporation of the State of New York engaged in the buying, mortgaging, selling, and improving of real property and letting of buildings erected thereon. Its

capital stock consists of six shares of $100 each. The only business it has ever done was the purchasing of the land and the erection of an office building thereon known as No. 42 Broadway. It executed first and second mortgages on the premises to secure its bonds. The business has always been conducted at a loss. By contract dated April 8, 1910, it sold the premises, and they were actually conveyed to the purchaser December 30 and settlement made as of September 30, 1910.

February 27, 1911, it filed a return of net income for the year 1910 under section 38 of the act of August 5, 1909, known as the United States corporation-tax law. April 10, 1911, it filed
81 under protest an amended return made out in accordance with the requirements of the Commissioner of Internal Revenue showing a gross income of $306,817.21 and a net income of $178,136, the assessment upon which of $1,781.36 it paid under protest to the defendant, collector of internal revenue for the Second District of New York. April 15 it appealed from the assessment to the Commissioner of Internal Revenue and demanded a refund. June 5 the commissioner denied the appeal, and November 4 it brought this action against Anderson to recover the amount paid.

The second paragraph of section 38 describes how net income should be ascertained:

"Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company received within the year from all sources (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property; * * * (third) interest actualy paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint-stock company or association, or insurance company outstanding at the close of the year. * * *"

The company claims that there should have been deducted from the gross income interest paid in the year 1910 as follows:

Interest on first mortgage, a lien on real property of company securing bond of the company, accrued and paid in 1910	$135,000.00
Interest on second mortgage, a lien on real property of company securing bond of company, accrued and paid in 1910	25,000.00
Interest on second mortgage, a lien on real property of company securing bond of company, accrued prior to 1910, but paid in 1910	76,527.77
82 Other interest on bonded and other indebtedness of the company contracted in the maintenance and operation of the business and properties of the company, such interest being a liability incurred or paid as a necessary expense in the maintenance of the business and properties of the company:	
Total of such interest accrued and paid in 1910	47,715.16
Total of such interest accrued prior to 1910 but paid in 1910	55,274.00
	$339,516.93

The commissioner allowed only interest on so much of the mortgage indebtedness as equaled the paid-up capital stock of $600, viz, $36.00. If the interest on the company's bonds secured by mortgage on its property accruing and paid in 1910, $160,000, should have been deducted from the gross income, the net income would be $23,171.75 and the tax $231.71, and if the interest accruing in 1909 but paid in 1910, $76,527.77, should also have been deducted, there would be no net income at all and the whole tax should be refunded.

The Government admits that if the interest had not been paid the mortgages would by their terms have fallen due and if foreclosed the company would have lost its property. It seems to us that these payments of interest on bonds of a corporation engaged in the realty business secured on its realty were ordinary and necessary expenses in the "maintenance and operation" of such business and were also charges required to be paid as a "condition of the continued use or possession" of its property within subdivision 1 of paragraph 2 of section 38. As subdivision 3 relates specifically to interest, it should on accepted principles of construction control and take interest out of subdivision 1 unless both subdivisions can be construed together consistently so as to leave it in. We think this can be done by construing indebtedness in subdivision 3 to be the usual corporate indebtedness which is not an ordinary expense of maintenance nor a charge, payment of which is a condition of the continued use or possession of property. The bonds of a company like this, en-
83 gaged in realty business secured by mortgages on its realty, we think is not such an indebtedness. Our conclusion does not depend upon the circumstance that there was in point of fact no net income at all, the business having been conducted at a loss. Corporations in similar case may be taxable when net income is ascertained in the manner provided in the act.

Furthermore, we think that such interest actually paid within the year, though previously accruing, should be deducted. The act expressly defines both the maintenance expenses and the interest on indebtedness to be such as is "actually paid within the year." This seems to us reasonable, because the net income which measures the tax is the income received during the year and the deductions should be of sums paid during the year. Otherwise there will never be a credit for interest not paid within the year in which it accrued. The judgment is affirmed.

A. S. PRATT,
Asst. U. S. Attorney, for the Plaintiff in Error.
R. S. BALDWIN,
For the Defendant in Error.

84 At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court rooms in the post-office building in the city of New York, on the 8th day of May, one thousand nine hundred and fourteen.

Present: Hon. E. Henry Lacombe, Hon. Alfred G. Coxe, Hon. Henry G. Ward, circuit judges.

CHARLES W. ANDERSON AS COLLECTOR, ETC., PLAINTIFF IN error
vs.
FORTY-TWO BROADWAY COMPANY, DEFENDANT IN ERROR.

Error to the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.

A. C. C.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

85 (Endorsed:) United States Circuit Court of Appeals, Second Circuit. C. W. Anderson vs. 42 B'way. Co. Order for mandate. United States Circuit Court of Appeals, Second Circuit. Filed May 8, 1914. William Parkin, clerk.

86 UNITED STATES OF AMERICA,
Southern District of New York, ss.:

I, William Parkin, clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 85, inclusive, contain a true and complete transcript of the record and proceedings had in said court in the case of Charles W. Anderson, as collector, etc., against Forty-two Broadway Company, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, in the Second Circuit, this 15th day of May, in the year of our Lord, one thousand nine hundred and fourteen, and of the Independence of the said United States the one hundred and thirty-eight.

[SEAL.] WM. PARKIN, *Clerk.*

87 In the Supreme Court of the United States, October term, 1914.

CHARLES W. ANDERSON, COLLECTOR, ETC., petitioner,
vs.
THE FORTY-TWO BROADWAY COMPANY, } No. 623.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the record now on file in the

Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Second Circuit to the writ of certiorari granted herein.

JNO. W. DAVIS,
Solicitor General.

ROGER S. BALDWIN,
Counsel for Respondent.

October 28, 1914.

(Endorsed:) Anderson vs. 42 Broadway Co. Stipulation. United States Circuit Court of Appeals, Second Circuit. Filed Nov. 7, 1914. William Parkin, clerk.

88 **United States Circuit Court of Appeals, Second Circuit.**

To the Supreme Court of the United States, greeting:

The record and all proceedings whereof mention is within made having lately been certified and filed in the office of the clerk of the Supreme Court of the United States, a copy of the stipulation of counsel is hereto annexed and certified as a return to the writ of certiorari issued herein.

Dated New York, November 9th, 1914.

[SEAL.] WM. PARKIN,
Clerk of the United States Circuit Court of Appeals for the Second Circuit.

89 UNITED STATES OF AMERICA, *ss:*

The President of the United States of America, to the honorable the judges of the United States Circuit Court of Appeals for the Second Circuit, greeting:

Being informed that there is now pending before you a suit in which Charles W. Anderson, collector of internal revenue of the United States of America for the second district of New York, is plaintiff in error and The Forty-two Broadway Company is defendant in error, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Southern District of New York, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the
90 United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon, as of right and according to law ought to be done.

Witness the honorable Edward D. White, Chief Justice of the United States, the twenty-seventh day of October, in the year of our Lord one thousand nine hundred and fourteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

91 (Indorsed:) File No. 24,367. Supreme Court of the United States, No. 623, October term, 1914. Charles W. Anderson, collector of internal revenue, etc., vs. The Forty-two Broadway Co. Writ of certiorari. United States Circuit Court of Appeals, Second Circuit. Filed Nov. 7, 1914, William Parkin, clerk.

92 (Indorsed:) United States Circuit Court of Appeals, Second Circuit. Chas. W. Anderson, as collector, etc., v. 42 Broadway Co. Return to certiorari. Office of the clerk, Supreme Court U. S. Received Nov. 12, 1914.

93 (Indorsed:) File No. 24,367. Supreme Court U. S. October term, 1914. Term No. 623. Charles W. Anderson, collector of internal revenue, etc., petitioner, vs. The Forty-two Broadway Company. Writ of certiorari and return. Filed November 12, 1914.

O

In the Supreme Court of the United States.

OCTOBER TERM, 1914.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE OF THE UNITED STATES OF AMERICA FOR THE SECOND DISTRICT OF NEW YORK, petitioner,
v.
THE FORTY-TWO BROADWAY COMPANY.

No. —.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF THEREON.

To the Supreme Court of the United States:

The Solicitor General, on behalf of Charles W. Anderson, collector of internal revenue of the United States of America for the second collection district of New York, prays for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit in the above-entitled cause.

QUESTION PRESENTED.

The case presents the question whether, in determining net income under paragraph second of section 38 of the Corporation Tax Act of August 5, 1909, 36 Stat. 11, 113, payments of interest on

bonds of a corporation engaged in leasing and operating an office building erected by it on its own realty (which bonds are secured by mortgages on said premises) constitute, on the one hand, "*ordinary and necesary expenses * * * in the maintenance and operation of its business and property*" or "*charges * * * required to be made as a condition to the continued use or possession*" of said property, under clause first of said paragraph, and as such are wholly to be deducted from "gross income"; or, on the other hand, constitute "*interest * * * on its bonded or other indebtedness*" under clause third, and as such are to be deducted only "to an amount * * * not exceeding the paid-up capital stock of such corporation * * * outstanding at the close of the year."

THE FACTS.

The Forty-two Broadway Company is a so-called realty corporation, and the only busines it has ever done was the purchasing of land and the erection and maintenance of an office building thereon known as "Forty-two Broadway." It has a total capital stock of but six shares, of the par value of $100 each, and a bonded indebtedness of $4,750,000, secured by a mortgage upon its realty. (R., 6, 7.) It paid in the year 1910 by way of interest $339,516.93 (R., 14, 22), which exceeded the entire amount of its gross income, leaving, if deducted, its net income *nil*. If allowed to deduct

only interest on so much of its mortgaged indebtedness as equals the paid-up capital of $600, viz, $36, there remains a net income of $178,136; and the collector of internal revenue accordingly collected, over the protest of the company, 1 per cent on this latter amount, or $1,781.36. (R., 5.) This sum the company sues to recover.

The District Court, 209 Fed. 991, and the Circuit Court of Appeals, 213 Fed. 777, each held that the interest payments upon this mortgage indebtedness fell under clause first of paragraph second of section 38, *supra*, and accordingly gave judgment against the collector for a refund of the entire tax.

REASONS FOR THE ALLOWANCE OF THE WRIT.

If this decision be acquiesced in, the Government will doubtless be forced to refund many thousands of dollars in taxes similarly collected.

The revenue under the Income Tax Act of October 3, 1913, 38 Stat. 114, 166, will probably be affected, since the language of the latter act, while not identical, is quite similar to that of the act here involved.

The case is thus one of general public importance. It is believed that the decision is in conflict not only with the express language of the act but with the general principles governing the same, as heretofore enunciated by this court.

Section 38 of the act of August 5, 1909, 36 Stat. 11, 112, so far as material, provides:

> That *every corporation* * * * organized for profit and having a capital stock represented by shares * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above five thousand dollars, etc., etc.
>
> *Provided, however,* That nothing in this section contained shall apply to (here are enumerated many special organizations, but not, however, realty corporations).
>
> Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first, all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges, such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; * * * (third, interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the *paid-up* capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year.

I.

Interest on bonded indebtedness must be deducted in precisely the same way when paid by a realty corporation as when paid by any other corporation not within the classes specifically enumerated in the act.

The learned Circuit Court of Appeals, while conceding that this tax might be imposed though the company were actually operated at a loss during the particular year, and further conceding that as to corporations generally interest paid by them would fall under the third rather than the first clause of paragraph second, yet holds that bonds of a company like this, engaged in the realty business, secured by mortgages on its realty, do not fall under the third clause. Thus the court announces an exception in favor of realty corporations not found within the language of the act and discountenanced, in effect, by the previous decisions of this court.

The proviso to the first paragraph of section 38 expressly exempts labor, agricultural or horticultural associations, fraternal beneficiary societies, domestic building and loan associations, and corporations organized exclusively for religious, charitable, or educational purposes, from the provisions of the act. Certain special provisions appear in paragraph second and paragraph third with reference to the assessment of banks, banking associations, and trust companies, companies organized under the laws of a foreign country, and insurance

companies. With these exceptions, the act recognizes no distinction between the various kinds of corporations which are subject to the tax. All are treated alike; all are subject to the same tax, to be assessed at the same rate on their net incomes, computed in the same manner; and no deductions are allowed to one that are not allowed to another.

A realty company, not being within the specifically enumerated exceptions, necessarily falls within the description of "every corporation * * * organized for profit and having a capital stock represented by shares." Indeed, it was expressly so held by this court in *Flint* v. *Stone Tracy Company*, 220 U. S. 107, wherein it was contended that corporations of this character were *sui generis* and not within the operation of the act. The court, however, said (p. 171):

> We think it is clear that corporations organized for the purpose of doing business, and actually engaged in * * * leasing property, collecting rents, managing office buildings * * * are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law.

This court in *McCoach* v. *Minehill Ry. Co.*, 228 U. S. 295, 302, 303, showed that the above quoted utterance was used in the *Flint* case in connection with said companies, the business of one of which, the Park Realty Company, "related only to the

management and leasing of one hotel "; and reviewing the *Zonne* case, 220 U. S. 187, involving a corporation which while originally organized to let stores and offices in the building owned by it, had afterwards leased property to trustees for one hundred and thirty (130) years, and amended its articles limiting its powers, said:

> The corporation involved in the present case, as originally organized and owning and renting an office building, was doing business within the meaning of the statute as we have construed it.

A similar effort to create an arbitrary exception in favor of mining corporations on the ground that the provisions of section 38 do not " fit the conditions of a mining company," and that " the application of the act to them results in a tax upon capital," was disapproved by this court in *Stratton's Independence, Limited,* v. *Howbert, Collector,* 231 U. S. 399, wherein the court said (p. 415):

> It seems to us that the first two questions certified must be answered in the affirmative principally for two reasons. First, because mining corporations are within the general description of section 38, which comprises " *every corporation,* joint stock company, or association *organized for profit and having a capital stock represented by shares* * * * and engaged in business in any State or Territory of the United States "; and, secondly, because the act *specifies those classes of corporations that are to be exempt* from its op-

eration, and mining corporations are not among them. * * * Moreover, the section imposes "a special excise tax with respect to the carrying on or doing business by such corporation," etc. That mining companies are doing business within the fair intent and meaning of this clause seems to us entirely plain for reasons already given.

The statute has not distinguished, and therefore the courts can not distinguish, realty corporations from other corporations not specifically enumerated.

II.

The right to deduct interest actually paid within the year in estimating net income is covered by clause third of paragraph second alone, and clause first has no application whatever to interest payments.

Interest paid on indebtedness to a certain amount is specifically and *eo nomine* allowed as a deduction under clause third and is referred to by name in no other portion of the statute. *Expressio unius est exclusio alterius.* This specific declaration of legislative intent leaves little room for interpretation or construction. It is so plain that "he who runs may read."

"Bonded or other indebtedness" is a phrase sufficiently broad to include every kind of debt.

French v. *Burlington,* 42 Ia. 614, 617.
Council Bluffs v. *Steward,* 1 N. W. 628, 635.
Underhill v. *Company,* 28 Pac. 1049, 1051.

In view of the language of the act, interest can not be treated as "an ordinary and necessary expense of maintenance or operation," or as "a charge such as rental or franchise payment."

The deliberate distinction thus made by Congress appears again in the third paragraph of section 38, with its detailed specification of items to be reported; and again in the Income Tax Act of 1913, 38 Stat. 114, 167, where, under "deductions," are enumerated "the necessary expenses actually paid in carrying on any business"; and later "all interest paid * * * on indebtedness." The contrast is emphatic.

The suggestion that if some way be not found to deduct all interest paid, the tax might be laid as for net income where there was none in fact, is without force when we remember that the tax is on the *privilege* of *doing* business and is not limited at all to profit-taking years. This fact the learned District Court patently overlook, saying, "The object of this statute was to impose a tax upon the net income of corporations." This mistaken theory of the law appears and reappears throughout its opinion. 209 Fed. 992–993.

The business is done every year, and in doing it the corporation takes its chances on gain or loss. It pays the tax for the opportunity to make a gain, and the tax is measured by the so-called net income, arrived at in an arbitrary manner prescribed by the act itself.

In *Stratton's Independence, Limited, supra,* this court said (p. 414):

> * * * The act of 1909 avoided this difficulty by imposing not an income tax, but an excise tax on the conduct of business in a corporate capacity, measuring, however, the amount of tax by the income of the corporation, with certain qualifications prescribed by the act itself.

And again (p. 416):

> As to what should be deemed "income" within the meaning of section 38, it of course need not be such an income as would have been taxable as such. * * * It was reasonable that Congress should fix upon *gross* income, without distinction as to source as a convenient and sufficiently accurate index of the importance of the business transacted. And from this point of view it makes little difference that the income may arise from a business that theoretically or practically involves a wasting of capital.

Nor is it of any moment that the corporation here in question, if only its capital stock were $350,000 instead of $600, would have the benefit under the act of deducting all the interest paid. The real owners of this corporation are the bondholders, who are preferred creditors against the general or floating debt and who incur no substantial stock liability. Their position is doubtless a matter of choice upon their part, and for the privileges and immunities which they thus enjoy it is fitting that a higher

tax should be paid. Although operating unequally as between different classes, the act operates equally as to all corporations having a like capitalization, and it was doubtless the very purpose of the act either to prevent or to impose an extra burden upon corporations operating with a nominal capital stock and with the real ownership lodged in mortgage bondholders.

In *Flint* v. *Stone Tracy Company, supra,* this court said:

> Again, it is urged that Congress exceeded its power in permitting a deduction to be made of interest payments only in case of interest paid by banks and trust companies on deposits, and interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of the corporation or company. *This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax.* In any event, we see no reason why this method of ascertaining the deductions allowed should invalidate the act. Such details are not wholly arbitrary, and were deemed essential to practical operation. Courts can not substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed (p. 173).

> * * * *the tax must be measured by some standard, and none can be chosen which will operate with absolute justice and equality upon all corporations.* Some corporations do a large business upon a *small amount of capital;* others with a *small business* may have a large capital (p. 165). (Italics ours.)

In *Stratton's Independence, Limited,* v. *Howbert, Collector, supra,* this court said (p. 416):

> * * * Evidently Congress adopted the income as the measure of the tax to be imposed with respect to the doing of business in corporate form because it desired that the excise should be imposed, approximately at least, with regard to the amount of benefit presumably derived by such corporations from the current operations of the Government.

See also the opinion of Attorney General Wickersham, 28 Op. 199, and *United States* v. *Whitridge,* 231 U. S. 144.

The language of the act is unambiguous, and there is no sound reason for reading it otherwise than according to its natural meaning.

It is respectfully submitted that a writ of certiorari should issue as prayed.

JOHN W. DAVIS,
Solicitor General.
WM. WALLACE, JR.,
Assistant Attorney General.

OCTOBER, 1914.

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1914

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1914.

CHARLES W. ANDERSON, Collector of Internal Revenue of New York,
Petitioner,

AGAINST

THE FORTY-TWO BROADWAY COMPANY.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

A tax of $1,781.36 was erroneously imposed and collected by the United States Government, to recover which this action was brought. The action was tried by the United States District Court under an Agreed Statement of Facts (R., 100 to 198), without a jury, a jury having been expressly waived in writing (R., 98). The Circuit Court of Appeals has unanimously affirmed the judgment of the District Court in favor of The Forty-two Broadway Company for the amount above mentioned with interest.

Two questions of construction of the United States Corporation Tax Law contained in Section 38 of the Act of Congress, approved August 5th, 1909, are presented for determination by this petition;

FIRST: Should interest payments on bonds of a corporation, and especially of a corpora-

tion doing essentially a real estate or realty business, which bonds are secured by mortgages on real property of such corporation, be allowed to be deducted as a part of the ordinary and necessary expenses of the corporation in the maintenance and operation of its business and properties, required to be made as a condition to the continued use or possession of its property.

SECOND: If such interest payments are allowed to be so deducted, should, as provided by the Statute, and as claimed by The Forty-two Broadway Company, the interest "actually paid" within the year be so allowed, or, as ruled by the Treasury Department of the Government, should only the interest *accrued* within the year be allowed to be deducted.

The first paragraph of the Corporation Tax Law provides as follows:

> "That every corporation * * * shall be subject to pay annually a special excise tax * * * equivalent to one per centum upon the entire *net* income over and above five thousand dollars *received* by it from all sources during such year."

The Second paragraph of the Corporation Tax Law, allowing deductions from gross income in order to ascertain the net income upon which the tax should be based, provides as follows:

> "SECOND. Such *net* income shall be ascertained by deducting from the gross amount of the income of such corporation * * * *received* within the year from all sources, (first) *all* the *ordinary and necessary* expenses *actually paid* within the year out of income in the maintenance and operation of its business and properties, including *all* charges such as rentals or franchise payments, *required to be made as a condition to the continued use or possession of property;* * * * (third) interest *actually paid* within the year on its *bonded* or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, * * * outstanding at the

close of the year, and in the case of a bank, banking association or trust company, all interest *actually paid* by it within the year on deposits * * *".

Italics are our own and for the purpose of designating those words to which special reference will later be made on this brief.

The Facts.

The Forty-two Broadway Company was organized for the purpose of acquiring the property known as No. 42 Broadway, New York City, and constructing an office building thereon, and has at no time transacted any other business. The capital stock of The Forty-two Broadway Company is and has always been only $600, and the funds with which it acquired title to such property and constructed and operated such office building were obtained, with the exception of the $600 capital stock above referred to, entirely through loans made to such Company (R., 110).

As is shown in Paragraph XVII. of the Agreed Statement of Facts (R., 121), the financial plans and arrangements of The Forty-two Broadway Company were of a character customarily followed and adopted by realty companies in New York City at the times in question.

If interest on its mortgages is to be figured as an expense of operation, The Forty-two Broadway Company was at all times operated at a loss, and has had no net income, and particularly during the year ending December 31st, 1910 had or earned no net income, the income and receipts of such Company in no year exceeding the expense of operating its building and paying interest and other charges and expenses against it (R., 110–111).

The interest, which it is claimed should be allowed as a deduction from gross income in order to arrive at the net income upon which the tax of The Forty-

two Broadway Company should be based, all of which interest was *actually paid* within the year 1910, and paid out of the income of the Company, amounted, as shown in paragraph XI of the Agreed Statement of Facts (R., 112–114), to $339,516.93, of which $160,000 was interest accruing and paid on mortgages on the 42 Broadway building in 1910, $76,527.77 was interest accruing on mortgages on the 42 Broadway building prior to 1910, but paid in 1910, and the balance was interest on other indebtedness of the Company not secured by mortgage, part of which accrued in 1910, but all of which was paid in 1910.

The net income of The Forty-two Broadway Company for the year 1910, as claimed by the Government, without allowing for any such interest payments, except to the extent of 6 per cent. on the capital stock of $600, or in other words, $36, was $178,135.75, making the 1 per cent. tax on such net income amount to $1,781.36. Provided, therefore, the contentions of The Forty-two Broadway Company are sustained by this court, it is only necessary for such Company, in order to be entitled to judgment for the amount of the tax paid, to be entitled to a deduction, from such net income, of the amount of the interest paid during the year 1910 on its mortgages, as the interest paid on such mortgages alone exceeds the net income claimed by the Government as a basis for the computation of the tax.

It is admitted, as shown by paragraph XVII of the Agreed Statement of Facts (R., 121–122), that all of the interest above referred to is an ordinary and usual expense of realty companies of the character of The Forty-two Broadway Company, although in making this admission, the Government does not admit that the payment of such interest is "an ordinary and necessary expense" within the meaning of the Act. It is, however, admitted, as shown by paragraph XI. of the Agreed Statement of Facts (R., 114), that the interest in question was paid out

of the income of The Forty-two Broadway Company in accordance with the provisions of its mortgages and other securities, and that the rates of such interest were those ordinarily paid on mortgages and other securities of a realty corporation such as that of The Forty-two Broadway Company. It is further admitted that, if such interest had not been paid, the mortgages and other securities would have fallen due, and that The Forty-two Broadway Company would have been subject to the foreclosure of its mortgages and to suit on its securities, and that if such mortgages had been foreclosed, The Forty-two Broadway Company would have lost its property, and that if such suits had been brought on such securities, and judgment obtained, the property of The Forty-two Broadway Company would have been subject to levy and sale under execution.

POINT I.

The interest on the mortgages of The Forty-two Broadway Company was a part of the ordinary and necessary expenses of the company in the maintenance and operation of its business and properties and required to be made as a condition to the continued use or possession of property.

1. It is well settled that the tax imposed, under Section 38 of the Act of Congress of August 5th, 1909 (36 Stat. at Large, 112) is an *excise* tax, rather than an *income* tax, but we respectfully submit that whatever the tax may be called, it must be under the terms of the Act, "*equivalent*" to one per cent. upon the "*net income*" of the corporation over

and above $5,000 "*received*" by the corporation during the taxable year.

This presupposes the existence of a net income, and a net income "*received*," not *accrued*. The Forty-two Broadway Company had no *actual* net income for the year ending December 31st, 1910 (R., 110-111). In addition to this apparent fact, however, it is submitted that The Forty-two Broadway Company had no net income, as *ascertained* by the terms of paragraph "Second" of the Act.

Such paragraph "Second" provides that the net income of a corporation shall be ascertained by making certain deductions from its gross income, among which are

> "(first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property."

The payments of interest on mortgages were certainly a part of "*all ordinary and necessary*" expenses of the corporation. No expense could be more ordinary and necessary, and it should be noted that the language of this Act expressly includes "*all*" ordinary and necessary expenses.

There is no dispute but that the interest in question was "*actually paid*" by The Forty-two Broadway Company (R., 111), and in this connection it should be noted that the expenses referred to in the Act are not those which have *accrued*, but those which have been "*paid*", the necessity of payment being further emphasized by the word "actually" qualifying the word "paid". This language, repeated several times in the subdivision marked "(Second)" of the Act and the provision in the First paragraph of the Act, which provides that the tax shall be equivalent to one per centum upon the entire net income of the corporation over and above five thousand dollars "*received*" by it from all

sources, should determine once and for all, that the tax is determined by receipts and actual payments, and not, as ruled by the Treasury Department, by accruals.

There is further no dispute but that the interest paid by The Forty-two Broadway Company was paid "*within the year*" (R., 111) and was paid "*out of income*" (R., 114).

Such interest payments were clearly made "*in the maintenance and operation of its*", the Company's "*business and properties.*" In the case of all corporations, but particularly in the case of a corporation organized for the business of dealing in a specific parcel of real property, such payments are one, if not the most important, of the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation.

Such interest payments were further certainly one of "*all charges*" against the property of the corporation, such language clearly embracing the most usual and, next to taxes, the most fundamental charge, against real property, namely, interest on mortgages. It certainly could not have been intended by Congress, nor should it be held, that all the rest of the language used in connection with deductions allowed under subdivision "(first)" of paragraph Second of the Act should be so negatived and limited by the use, after the words "all charges", of the words "such as rentals or franchise payments", so as to take out of the meaning of the Act the chief item of expense paid by a corporation, which falls within all the other requirements of the Act.

There is also no question but that such payments were "*required to be made as a condition to the continued use or possession of property.*" There is, as above stated, certainly no expense which it is more necessary to pay for the continued use or possession of property than that of interest on the mortgages on such property, and no expense, which the failure to pay will more quickly or certainly result in the loss of property.

2. While interest payments on mortgages are always a part of the ordinary and necessary expenses of a corporation, such payments were particularly so in the case of this specific corporation, organized for and transacting a specific piece of realty business—namely, the purchase of a particular parcel of land, and the erection and operation thereon of a large office building.

If it were necessary, a distinction might be made between a corporation such as The Forty-two Broadway Company transacting a business such as the business of The Forty-two Broadway Company and a corporation conducting other forms of business. In the case of The Forty-two Broadway Company, the mortgaging of its property was not incidental to its business, but formed one of the main features of its business. The whole capital of the Company was bound up in this one venture and the payment of interest on its mortgages constituted its chief item of expense. It is also interesting to note, and we submit that this should have some weight with this Court, that, apart from any technical construction of the Act it is undisputed as a matter of *fact* that the payment of such interest was a part of the "ordinary and necessary expense" of the company paid "in the maintenance and operation of its business and properties" (R., 114), and that such payment and expense were, as provided by the Act under the first subdivision of allowable deductions, "required to be made as a condition to the continued use or possession of property" (R., 115).

As pointed out by the Circuit Court of Appeals in its opinion, the interest paid by the ordinary corporation on its bonded or other indebtedness in the conduct of a general business is, of course, quite distinguishable from the interest on the mortgages here in question, and in fact is distinguished by the Act itself. The language used in the Act shows that Congress included the interest on mortgages of this character as a part of the ordinary and necessary expenses of a corporation in the maintenance

and operation of its business and properties, leaving, as falling under subdivision (third) of allowable deductions, such interest as might be paid on other bonded or other indebtedness of the corporation, the failure to pay which would not result in foreclosure and the consequent deprivation of the use or possession of property.

3. It is maintained by the Government that the interest on the mortgages above referred to is specifically allowed under the deduction marked "(third)" in the Act, and that, therefore, the allowance of such interest is limited by the terms of the Act allowing such deduction. This contention of the Government, we respectfully submit, is unsound. The deduction of interest on mortgages is clearly within the terms of the deduction marked "(first)", if such interest is a part of the ordinary and necessary expenses, and required to be paid as a condition to the continued use and possession of the property, and such deduction is clearly allowable under such portion of the Act, although it may also be allowable under other portions. As stated by the Circuit Court of Appeals in its opinion, both Subdivision "(first)" and Subdivision "(third)" may be consistently construed so that both cover interest payments, Subdivision "(third)" being considered as referring more particularly to the usual corporate indebtedness.

In this connection it may be observed that under the deduction marked "(third)," the interest referred to is the interest on "*bonded*" or other indebtedness of the corporation. We have, however, found no authority to the effect that the word "bond" includes a mortgage, and the word should not be so construed. A bond and a mortgage are separate securities though for the same debt, and the one does not include the other. Thus a bond is defined in Bouvier's Law Dictionary as being "an

obligation in writing and under seal," and this definition is supported by the authorities.

See Koshkonong *vs.* Burton, 104 U. S., 668, 673.

It might be urged, therefore, that interest on the indebtedness of a corporation secured by a mortgage is not specifically included within deduction "(third)" of the Act, while the interest on indebtedness secured by mortgage, such as here in question, is specifically included within deduction "(first)" among "ordinary and necessary expenses," and as a payment "required to be made as a condition to the continued use or possession of property."

4. It has been suggested that Congress intended to prevent the carrying on of business by corporations with a small capital stock and a large bonded indebtedness. If this is so, such fact is not stated in the Act, but whatever may be contended as to the purpose of Congress, it will, we are sure, not be contended that any Federal or State Legislature in these times would intentionally pass any legislation encouraging over-capitalization, or the capitalization of real property at its gross value rather than at the value of the equity owned by the corporation. If the suggestion in this connection is correct, it would follow, necessarily, that in order to be able to deduct interest on its mortgages as an expense, a corporation which holds real property subject to mortgage would have to incorporate for an amount largely in excess of the real value of its interest in such property. In other words, where a corporation holds real property, as 90 per cent. of the real property in New York City is to-day held, subject to a mortgage of at least two-thirds or the value of such property, the capitalization of such corporation, in order to meet this suggestion, would have to be at three times the real value of the property to represent which its capital stock was issued. Such a result, of course, was never intended by the United States

Congress, and any construction which involves any such result must be erroneous and unintended by those who created the language of the Act.

The form of the organization of The Forty-two Broadway Company called for a small capitalization and a large indebtedness. This was not unusual or in any way improper. The purpose of Congress in limiting the deduction of interest on general indebtedness was without doubt to prevent the incurring of unusual and unfair debts in order to escape the corporate tax. It was appreciated, however, as is indicated by the Act itself, that the allowance of an indebtedness which was secured by property would not be so open to the danger above referred to, while the safeguards thrown around such expense, namely, that it should be *ordinary* and *necessary*, and that it should be an expense which was *required to be made as a condition to the use or possession of property*, would fully protect the Government against unfair practices.

A construction of the Act which would deprive mortgagors of the right to deduct, as an expense, interest paid on mortgages, would work a great hardship and injustice imposed upon no other class of taxpayers. Such construction would create an arbitrary and unreasonable classification, and the Act, if so construed, might on this ground be held to be unconstitutional under the Fifth and Fourteenth Amendments of the Constitution of the United States.

Connolly *vs.* Union Sewer Pipe Co., 184 U. S. 540, 560.

Cotting *vs.* Kansas City Stock Yards Co., 183 U. S., 79, 111.

POINT II.

If, in construing the Corporation Tax Law, there is any reasonable doubt as to what construction should be placed upon the Act, all reasonable doubts should be resolved against the Government and in favor of the taxpayer.

The contention of The Forty-two Broadway Company does not violate any of the general rules of construction, including those referred to by the Government on its brief. On the contrary, we submit that the contention of The Forty-two Broadway Company as to the proper construction to be placed upon the Act in question is essentially in accordance with such rules.

If, however, there is any doubt as to the construction which should be placed upon this or any other portion of the Corporation Tax Law, it is, of course, well settled, in construing a statute imposing a tax, that all reasonable doubts should be resolved against the Government and in favor of the person taxed.

There are no authorities which can be cited on the precise question involved, as the issue here raised has not been before this presented for adjudication. The question, however, has been a much discussed one, and was raised early in the enforcement of the Corporation Tax Law, as is evidenced by the opinion of the Honorable George W. Wickersham, Attorney General of the United States, which opinion is dated February 21st, 1910, and a copy of which is annexed to the brief of the Government, submitted to the Circuit Court of Appeals herein. In the giving of this opinion the Attorney General, as he stated, departed from the general custom and rendered an opinion upon a merely hypothetical and general question in view of the great

importance of the statute to the many interests affected thereby. The equity of the position of The Forty-two Broadway Company would seem to be recognized by the Attorney General, as in his opinion above referred to, he endeavored to distinguish, for the benefit of corporations, between those cases where the interest payments were on mortgages securing bonds of the corporation itself, interest on which he ruled could not be deducted, and those cases where interest payments were on bonds of other corporations or individuals not assumed by the corporation, interest on which he ruled could be deducted. This distinction was for a time adopted by the Treasury Department of the United States, but later was not followed, thus repudiating the part of the opinion of the Attorney General which was favorable to the tax payer, while to sustain its present position the Government has cited that part of such opinion which is favorable to the Government. (See form of Return 1032 issued by the Treasury Department, and Article 148 of Treasury Regulations under new Income Tax Laws of 1913, where the language used in this connection is almost identical with the language used in the old Act of 1909.)

In the last paragraph of his opinion, the learned Attorney General stated that a payment of interest on a mortgage, which had not been assumed by a corporation, would not be a payment, under Subdivision "(Third)" of paragraph Second of the Act, of interest on "*its* indebtedness", this being the language of the Act, and so deductible, and continues as follows:

> "The interest accruing upon such charge or encumbrance would certainly fall within the description of the first clause of the second paragraph of the section under consideration as one of the 'charges * * * required to be made as a condition to the continued use or possession of property,' and therefore would be deductible as such."

Here is substantiation for our contention that the payment of interest on a mortgage falls within the language of Sub-division "(first)" of the Act, if for no other reason, certainly as a "*charge*" required to be made as a condition to the continued use or possession of property.

The distinction between the deductions allowed under sub-divisions "(first)" and "(third)" of the Act is clear when proper effect is given to the words "ordinary and necessary", and to the clause which further describes the payments as being "required to be made as a condition to the continued use or possession of property."

POINT III.

The Corporation Tax Law should be administered upon the basis of "receipts" and "payments", as expressly provided in the law.

If the court should decide in favor of The Forty-two Broadway Company, the question will arise as to what portion of the $339,516.93 of interest paid by The Forty-two Broadway Company (R., 112–114) should be allowed as a deductible expense. It would seem clear that the item of $135,000, interest on first mortgage accrued and paid in 1910, and the item of $25,000. interest on second mortgage accrued and paid in 1910 should be allowed, and such allowances aggregating $160,000, would, if deducted from the assessment of $178,136 75, reduce such assessment against The Forty-two Broadway Company for the year 1910 to $18,135.75, without reference to the specific deduction of $5,000 allowed by the Act. The items of interest amounting to $47,715.16 and $55,274 paid on other indebtedness of the Company, and not being interest on mortgages, might not be considered by the Court as properly

deductible under paragraph "(first)" of the Act, not being required to be made as a condition to the continued use or possession of property. If the Court should come to this conclusion, the only remaining item of interest claimed by The Forty-two Broadway Company as a deductible expense is the item of $76,527.77, which was interest on a second mortgage, but which interest, although *paid* in 1910, *accrued* prior to 1910.

The allowance or disallowance of this item depends upon the construction which the Court may give to the word "paid" contained in the Act. An examination of paragraph Second of the Act will show that all the deductions are based upon *payments*, and not upon *accruals*. The Treasury Department of the United States, among other regulations with respect to what deductions shall be allowed, ruled, as shown by Note B annexed to the prescribed form of Return (R., 37), as follows:

> "the deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the Return and entered on its books from January 1st to December 31st,"

thereby adding to the Act the condition that the expense shall not only be "paid" by the corporation, but shall also be "entered on its books from January 1st to December 31st." The Treasury Department has further construed the Act as based upon *accruals* rather than as stated by the Act, upon *payments*. This construction would seem to be without authority in the Act and improper, and, as above set forth, it is claimed by The Forty-two Broadway Company that the interest on its second mortgage, which accrued prior to 1910, but which was *paid* in 1910, should be allowed as a further deduction from the gross income of the Company for the year 1910, thereby wiping off the assessment for such year, and entitling The Forty-two Broadway Company, under the stipulation herein (R., 117-119)

to a judgment against the Collector of Internal Revenue for the sum of $1,781.36, with interest from April 29th, 1911, which judgment should be allowed in this action. This is the view taken by the Circuit Court of Appeals for the Second Circuit, which in its opinion herein says:

> "The Act expressly defines both the maintenance expense and the interest on indebtedness to be such as is 'actually paid within the year'. This seems to us reasonable, because the net income which measures the tax is the income received during the year, and the deduction should be of sums paid during the year."

This is also the view taken by the Court in Mutual Benefit Life Insurance Co. *v.* Herold, 198 Fed. Rep., 199, 214, 215, affirmed by the Circuit Court of Appeals for the Third Circuit, 201 Fed. Rep., 918, which is the only other case we have found in which this question, arising under the Act of 1909, has been determined.

It is respectfully submitted that the Petition of the Government should be denied.

Dated, New York, October 1914.

BALDWIN & HUTCHINS,
Attorneys for
The Forty-two Broadway Company.

ROGER S. BALDWIN,
Counsel.

In the Supreme Court of the United States.

OCTOBER TERM, 1914.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE, ETC., PETITIONER,
v.
THE FORTY-TWO BROADWAY COMPANY.
No. 623.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MOTION TO ADVANCE.

Comes now the Solicitor General and moves the court to advance this cause for hearing on a day convenient to the court at the next term.

This suit was instituted by The Forty-Two Broadway Company to recover a tax paid under protest and alleged to have been erroneously imposed under section 38 of the Act of August 5, 1909, 36 Stat. 112, known as the "Corporation Tax Act."

The case presents the question whether, in determining net income under paragraph 2 of said section, payments of interest on bonds of a corporation engaged in leasing and operating an office building erected by it on its own realty (which bonds are secured by mortgages on said premises) fall within the first clause of said paragraph and are to be wholly

deducted from "gross income"; or whether such payments come within clause three and are to be deducted "only to an amount * * * not exceeding the paid-up capital stock of such corporation * * * outstanding at the close of the year."

The District Court, 209 Fed. 991, and the Circuit Court of Appeals, 213 Fed. 777, each held that the interest payments on the mortgage securing the bonded indebtedness of the respondent company fell under the first clause of said paragraph, and gave judgment against petitioner for a refund of the entire tax collected.

The case is one of importance to the revenues.

Opposing counsel concur.

JOHN W. DAVIS,
Solicitor General.

APRIL, 1915.

○

In the Supreme Court of the United States.

OCTOBER TERM, 1915.

CHARLES W. ANDERSON, COLLECTOR OF Internal Revenue of the United States for the Second District of New York, petitioner,
v.
THE FORTY-TWO BROADWAY COMPANY. } No. 246.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER.

STATEMENT OF THE CASE.

The case presents the question whether in determining net income under paragraph second of section 38 of the corporation tax act of August 5, 1909, 36 Stat. 113, payments of interest on bonds of a corporation engaged in leasing and operating an office building erected by it on its own realty (which bonds are secured by mortgages on said premises) constitute, on the one hand, *"ordinary and necessary expenses * * * in the maintenance and operation of its business and property"* or *"charges * * * required to be made*

as a condition to the continued use or possession" of said property, under the *first* "deduction" provided for in said paragraph, and as such are wholly to be deducted from "gross income"; or, on the other hand, "*interest * * * on its bonded or other indebtedness*" under the *third* deduction of said paragraph, and as such are to be deducted only "to an amount * * * not exceeding the paid up capital stock of such corporation."

THE FACTS.

The Forty-two Broadway Company is a so-called realty corporation owning and renting an office building erected at 42 Broadway, New York City, upon land purchased and owned by the corporation. It has a total capital stock of six shares, of the par value of $100 each, and a bonded indebtedness of $4,750,000 secured by mortgages upon its realty. Its taxable net income for 1910 was, as claimed by the Government, $178,136, and the tax of 1 per cent on that amount, $1,781.36, was collected and paid under protest, the interest upon only so much of its bonded indebtedness as equals the paid-up capital of $600, viz, $36, being allowed as a deduction. The company claims that there should have been deducted from the said net revenue (1) the sum of $160,000, being interest both *accrued* and *paid* in 1910 upon its said mortgages, and (2) an amount ($76,527.77) more than sufficient to make the net income *nil*, being interest *accrued* upon one of said mortgages *prior to 1910*, but paid in that year.

There is also a claim (R. p. 10) that certain "other interest on bonded and other indebtedness," constituted proper deductions from gross income, had the latter not been more than balanced by the total of the two items just enumerated. Of these latter payments claimed to be deductible, $47,715.16 *accrued* and was paid in 1910, while $55,274 *accrued prior* to 1910, but was paid in that year. Although the validity of these latter claims are not directly in question, owing to the fact that the first two items, if deducted, wipe out the entire "net income" claimed by the Government, the claims are material and significant, in themselves, as showing the extent and nature of the contention of the corporation as to the proper construction of the corporation tax act. Had the gross income been sufficient to admit of further reduction, the corporation would have come here claiming the allowance of these latter items. The principles upon which the instant case is to be decided should be broad enough to apply to *all* of the claims made by the company.

The District Court (209 Fed. 991) held that the interest payments upon the mortgage indebtedness were deductible from gross income under clause 1 of paragraph 2 of section 38, *supra*, and gave judgment against the collector for a refund of the entire tax. The Circuit Court of Appeals for the Second Circuit sustained the District Court (213 Fed. 777).

STATUTE INVOLVED.

Section 38 of the act of August 5 (36 Stat. 11, 112), so far as material, provides:

> *That every corporation* * * * organized for profit and having a capital stock represented by shares * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above five thousand dollars, etc.
>
> *Provided, however,* That nothing in this section contained shall apply to [here are enumerated many special organizations, but not, however, realty corporations].
>
> Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporations, joint-stock company, or association, or insurance company, received within the year from all sources, (first, all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges, such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; * * * third, interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the *paid-up* capital stock of such corporation, joint-stock company, or association, or insurance company, outstanding at the close of the year, etc.).

ARGUMENT.

I. Deductions, from gross income, of interest payments are provided for only in Section 38, paragraph (Second), CLAUSE (Third). Clause (First) has no application whatever to interest payments.

"Interest * * * on bonded and other indebtedness" (to a certain limited amount) is specifically and *eo nomine* allowed as a deduction under clause Third, *supra*. This clause either contributed something in the process of classification undertaken in paragraph Second of section 38, or it did not. If "interest on bonded or other indebtedness" is deductible (to its full amount) under clause *one*, as claimed by the corporation in this case, clause *three* is of no effect. Indeed, it then becomes even contradictory, in its restrictive provision. It must be assumed that Congress meant what it clearly said and that interest on bonded or other indebtedness was to be deducted from gross income, *not in toto*, but

> to an amount * * * not exceeding the paid-up capital stock.

The question then is: Is interest paid on bonds, secured by a mortgage on the realty of the corporation, to be considered "interest paid on bonded or other indebtedness?" We answer: If not, *what could be* so considered. If clause three is not to be given effect in this case, it could never become operative. Courts will hesitate to thus, *by construction*, negative the operation of a part of an act of Congress. (*Montclair* v. *Ramsdell*, 107 U. S. 147, 152.)

Moreover, a court will never undertake *to construe* a statute unless there is disclosed a patent ambiguity. (*United States* v. *Wiltberger*, 5 Wheat. 76, 95; *United States* v. *Baltimore & Ohio Southwestern Railroad Company*, 222 U. S. 8, 13.)

In the instant case there is no ambiguity in the words of the act as to the extent to which "interest on bonded or other indebtedness" is to be allowed as a deduction. Congress has specifically placed the limitation. Instead of calling for the application of the rule, contended for by the corporation, that in statutory construction every reasonable doubt must be resolved against the Government, this case presents, not a problem of statutory construction at all, but simply one of administration of explicit provisions of a taxing act.

Respondent seeks to distinguish between "bonded indebtedness" and indebtedness secured by a mortgage. It is urged that the word "bond" does not include the concept involved in a mortgage. This may be true. But it does not follow that "bonded indebtedness" does not include indebtedness *evidenced by bonds* secured by a mortgage. Bonded indebtedness is to be distinguished, at least in its popular usage, from floating indebtedness. Bonds secured by a mortgage surely do not partake of the nature of a floating charge. At best, however, such argument by respondent is futile. The act provides that interest on bonded "*or other*" indebtedness shall be deducted only upon an amount of such indebtedness

equal to the amount of paid-up capital stock. A mortgage debt surely comes within the term "other indebtedness."

"But," respondent argues, "admitting that these interest payments *may be* deductible (to a limited amount) under clause 3, they are also deductible (and more agreeably, since *in toto*) under clause 1, as—

> ordinary and necessary expenses * * * in the maintenance and operation of its business * * *, required to be made as a condition to the continued use or possession of property.

Congress has deliberately distinguished interest payments from payments to be classified as "ordinary and necessary expenses." As to *why* Congress has so distinguished we are not inquiring, although it might well be said, as was suggested in the brief of the respondent in opposition to the petition for writ of certiorari (p. 10)—

> that Congress intended to prevent the carrying on of business by corporations with a small capital stock and a large bonded indebtedness.

The real owners of this corporation were the bondholders, who are preferred creditors against the general or floating debt and who incur no substantial stock liability. Their position is doubtless a matter of choice upon their part, and it is of no moment that the corporation, if only it had issued and sold a sufficient amount of capital stock, would have been entitled to deduct from gross income all of

these interest payments. For the privileges and immunities which the bondholders enjoy, it is by no means unreasonable that a higher tax should be paid. Although operating irregularly as between different classes, the act operates equally as to all corporations having a like capitalization, and it was doubtless the very purpose of the act either to prevent or to impose an extra burden upon corporations operating with a nominal capital stock and with the real ownership lodged in mortgage bond holders.

The argument made on behalf of the respondent that a construction of the act depriving mortgagors of the right to deduct as an expense, interest paid on mortgages, would work a great hardship and injustice upon a single class of tax payers, and thus render the act unconstitutional, has been held unsound by this court. In *Flint* v. *Stone Tracy Company* (220 U. S. 107), this court said:

> Again, it is urged that Congress exceeded its power in permitting a deduction to be made of interest payments only in case of interest paid by banks and trust companies on deposits and interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of the corporation or company. *This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax.* In any event, we see no reason why this method

> of ascertaining the deductions allowed should invalidate the act. Such details are not wholly arbitrary, and were deemed essential to practical operation. Courts can not substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed (p. 173).
>
> * * * *the tax must be measured by some standard, and none can be chosen which will operate with absolute justice and equality upon all corporations.* Some corporations do a large business upon a *small amount of capital;* others with a *small business* may have a large capital (p. 165). [Italics ours.]

In *Stratton's Independence, Limited,* v. *Howbert, Collector* (231 U. S. 399), this court said:

> * * * Evidently Congress adopted the income as the measure of the tax to be imposed with respect to the doing of business in corporate form because it desired that the excise should be imposed, approximately at least, with regard to the amount of benefit presumably derived by such corporations from the current operations of the Government. (416.)

In 28 Opin. A. G. 199, Attorney General Wickersham, in holding that a corporation could deduct interest paid upon "*its*" bonded indebtedness, only under the limitation found in the *third* clause, said:

> It surely can not be assumed that Congress, having specifically set a limitation to the amount of interest upon the indebtedness of a corporation which may be deductible from its

> gross income in reaching the measure of the tax under this law, left the way open in the first clause to eliminate the limitation imposed by the third, so that if, in any of the cases suggested by the allied real-estate interests, the indebtedness secured by mortgage upon the properties acquired by the respective corporations shall have been *assumed* by them and has thereby become *their* indebtedness, interest on such indebtedness can be deducted only to an amount not exceeding the interest on the paid-up capital stock of the respective corporations. On the other hand, cases are suggested in the communication submitted, where a realty corporation takes title to real property subject to a mortgage, but does not *assume* the indebtedness secured thereby. Under such circumstances, as is stated in the brief, "such mortgage is in no sense its indebtedness; the thing itself, i. e., the real property and not the corporation is liable for the mortgage and interest thereon; but in order that the corporation may maintain or keep possession of or not be ousted therefrom, the interest must be paid." (200.)

It was urged in the respondents' brief in opposition to the petition for a writ of certiorari in this case (p. 10) that under the Government's contention—

> in order to be able to deduct interest on its mortgages as an expense, a corporation which holds real property subject to mortgage would have to incorporate for an amount largely in excess of the real value of its interest in such property.

No such result follows from the Government's contention, and the above argument obviously misapprehends the Government's position and misapplies the principle for which the Government contends. "A corporation which holds real property *subject to mortgage*" comes within the express exception suggested in Attorney General Wickersham's opinion, and under the view taken by the Government in this case the facts assumed above by counsel for the corporation would allow deduction of interest paid upon an *unassumed* mortgage *as an expense*, and not as interest paid on *its* bonded or other indebtedness. Respondent in using the illustration of a mortgage not assumed wanders far from the instant case, in which the mortgage was the corporation's *own* instrument and the mortgage debt was therefore necessarily "*its* indebtedness," as those words are used in the clause to which the limitation of interest payment deductions must be applied.

This is but recognizing the distinction between an obligation *in rem*, and an obligation *in personam*, though they may subsist side by side, one in aid of the other. When there is no obligation *in personam*, the land owes the debt, and the owner of the equity of redemption may at any time withdraw from possession, and be subject to no personal liability. If, in order to retain possession, he pay the interest on the mortgage, though not obligated to do so, such payment may be called a "charge required to be made as a condition to the continued possession

of the property" though this point is not now before the court. But where there is an obligation *in personam*, in addition to the obligation *in rem*, so that a deficiency judgment can be obtained against the possessor, no amount of ingenuity can make the indebtedness of the corporation which has assumed the obligation *in personam* any other than "its indebtedness," nor prevent it from falling within the class specifically dealing with "such indebtedness."

The suggestion that if some way be not found to deduct all interest paid, the tax might be laid as for net income where there was none in fact, is without force when it is remembered that the tax is on the *privilege of doing* business and is not limited at all to profit-taking years. This fact the learned District Court patently overlooks, saying—

> "The object of this statute was to impose a tax upon the net income of corporations."

This mistaken theory of law appears and reappears throughout its opinion (209 Fed. 992).

The business is done every year, and in doing it the corporation takes its chances on gain or loss. It pays the tax for the opportunity to make a gain, and the tax is measured by the so-called net income, arrived at in an arbitrary manner prescribed by the act itself. The respondent while admitting that the tax imposed is an *excise* rather than an *income* tax, nevertheless argues that, whatever the tax may be called, it must be, under the terms of the act, "equivalent" to 1 per cent upon the "net income" of the cor-

poration. To all of which the Government agrees, insisting, however, that the "*net income*," to 1 per cent of which the tax is to be equivalent, is to be computed, *not* according to principles of bookkeeping which would be applied by the accountants or officers or stockholders of the corporation, but upon a basis specifically set forth by Congress in the act itself.

In *Stratton's Independence, Limited, supra*, this court said (p. 414):

> * * * The act of 1909 avoided this difficulty by imposing not an income tax, but an excise tax on the conduct of business in a corporate capacity, measuring, however, the amount of tax by the income of the corporation, with certain qualifications prescribed by the act itself.

And again (p. 416):

> As to what should be deemed "income" within the meaning of section 38, it of course need not be such an income as would have been taxable as such. * * * It was reasonable that Congress should fix upon gross income, without distinction as to source, as a convenient and sufficiently accurate index of the importance of the business transacted. And from this point of view it makes little difference that the income may arise from a business that theoretically or practically involves a wasting of capital.

The distinction made by Congress between "ordinary and necessary expenses," on the one hand, and "interest on indebtedness," on the other, is drawn

again in the third paragraph of section 38, with its detailed specification of items to be reported; and again in the income-tax act of 1913, 38 Stat. 114, 167, when, under "deductions," are enumerated "the necessary expenses actually paid in carrying on any business"; and later "all interest paid * * * on indebtedness."

The contrast is emphatic. The distinction is clearly drawn. The language is unambiguous, and there is no sound reason for reading it otherwise than according to its natural meaning. There is no warrant for changing the expressed intention of Congress. It must be apparent, however, from the language itself, that the District Court's opinion did seek to effect such a change.

The court said (p. 992):

> "Net income," of course, means gross income *after deducting all outgo* necessarily incident to the business.

And again:

> A computation of its net income by a method which did not include as an item to be deducted the interest it was paying on its mortgages *was an absurdity*.

However absurd it may have appeared to the District Court and whatever may be the definition which that court would give to the term "net income," the fact remains that Congress has specifically defined, for the purpose of the corporation tax act, the basis upon which "net income" is to be calculated, and

that basis may be modified only by statutory enactment, and not by judicial interpretation.

It is urged that these payments of interest were "required to be made as a condition to the continued use or possession" of the property, and that they were therefore deductible under clause 1. It is not true that the continued use or possession of the property depended upon the making of these payments. It may be admitted—it is so stipulated in the agreed statement of facts (R. p. 19)—that if this interest had not been paid the mortgages would have been *subject to foreclosure*. The important fact is, nevertheless, that out of all the interest payments claimed by the corporation to be deductible under clause 1, $131,800 had accrued prior to 1910, had *not* been paid when it became due, no foreclosure had resulted, and the company had continued in the use and possession of its property. It is fair to assume that it was to the interest of the bondholders *not* to foreclose. The value of their investment was to be calculated, presumably, in terms of a longer period than one year. Although, in this instance, it appears that the interest was eventually paid, it is not at all illogical to assume that, if the interest accruing prior to 1910 had never been paid, the bondholders would have elected not to foreclose, nor suffer the inevitable loss incident thereto.

The bondholders being the real holders, these interest payments were *not*, strictly speaking, required to be made as a condition to the continued

use or possession of the property. There is nothing in the Agreed Statement of Facts to that effect, and, as pointed out above, the actual facts prove the contrary to have been the case. The case is not like that of a *rental* or *franchise* payment, specifically mentioned in the statute. Neither a landlord nor a franchise-granting body has the same interest in the corpus of the business. Dispossession or forfeiture, or even foreclosure by an *adverse* mortgagee, present situations in which failure to make payments actually involves loss of the use or possession of the property. To give full force and effect to clause one it is by no means necessary to admit its operation in the case at bar; rentals and franchise payments clearly call for the application of clause one; interest on bonded or other indebtedness is specifically excepted.

As was pointed out, *supra*, the corporation's claim is not limited to interest paid upon the mortgages secured upon its realty. It claims also that certain "other interest on bonded and other indebtedness of the company" ($102,989) should have been deducted from gross income before a tax was laid, which claim shows clearly the basis and extent of the position of the respondent. "Interest on bonded or other indebtedness" (using the very words of the act), which Congress has expressly said should be deducted only to the amount of *paid up capital stock*, this respondent claims should be deducted to the full amount of the *interest*. Obviously, it becomes a question as to which shall prevail, the claim of respondent or the unambiguous language of Congress.

II. A "realty company" is not entitled to deduct interest payments to any larger amount than any other corporation.

The learned Circuit Court of Appeals, while conceding that this tax might be imposed though the company were actually operated at a loss during the particular year, and further conceding that, as to corporations generally, interest paid by them would fall under the third rather than the first clause of paragraph second, yet holds that bonds of a company like this, engaged in the realty business, secured by mortgages on its realty, do not fall under the third clause. Thus the court announces an exception in favor of realty corporations not found within the language of the act, and discountenanced, in effect, by the previous decisions of this court.

The proviso to the first paragraph of section 38 expressly exempts labor, agricultural or horticultural associations, fraternal beneficiary societies, domestic building and loan associations, and corporations organized exclusively for religious, charitable, or educational purposes from the provisions of the act. Certain special provisions appear in paragraph second and paragraph third with reference to the assessment of banks, banking associations, and trust companies, companies organized under the laws of a foreign country, and insurance companies. With these exceptions, the act recognizes no distinction between the various kinds of corporations which are subject to the tax. All are treated alike; all are subject to the same tax, to be assessed at the same rate on

their net incomes, computed in the same manner; and no deductions are allowed to one that are not allowed to another.

A realty company, not being within the specifically enumerated exceptions, necessarily falls within the description of "every corporation * * * organized for profit and having a capital stock represented by shares." Indeed, it was expressly so held by this court in *Flint* v. *Stone Tracy Company* (220 U. S. 107), wherein it was contended that corporations of this character were *sui generis* and not within the operation of the act. The court, however, said (p. 171):

> We think it is clear that corporations organized for the purpose of doing business and actually engaged in * * * leasing property, collecting rents, managing office buildings * * * are engaged in business within the meaning of this statute and in the capacity necessary to make such organizations subject to the law.

This court in *McCoach* v. *Minehill Ry. Co.* (228 U. S. 295, 302, 303) showed that the above-quoted utterance was used in the *Flint case* in connection with said companies, the business of one of which, the Park Realty Co., "related only to the management and leasing of one hotel"; and, reviewing the *Zonne case* (220 U. S. 187), involving a corporation which, while organized to let stores and offices in the building owned by it, had afterwards leased property to trustees for one hundred and thirty (130)

years, and amended its articles limiting its powers, said:

> The corporation involved in the present case, as originally organized and owning and renting an office building, was doing business within the meaning of the statute as we have construed it.

See also *Lewellyn* v. *P. B. & L. E. R. Co.*, 222 Fed., 180, 181, and cases cited.

A similar effort to create an arbitrary exception in favor of mining corporations on the ground that the provisions of section 38 do not "fit the conditions of a mining company," and that "the application of the act to them results in a tax upon capital," was disapproved by this court in *Stratton's Independence, Limited*, v. *Howbert, Collector, supra*, wherein the court said (415):

> It seems to us that the first two questions certified must be answered in the affirmative principally for two reasons. First, because mining corporations are within the general description of section 38, which comprises "*every corporation*, joint stock company, or association *organized for profit and having a capital stock represented by shares* * * * and engaged in business in any State or Territory of the United States;" and, secondly, because the act *specifies those classes of corporations that are to be exempt* from its operation, and mining corporations are not among them. * * * Moreover, the section imposes "a special excise tax with respect to the

carrying on or doing business by such corporations," etc. That mining companies are doing business within the fair intent and meaning of this clause seems to us entirely plain for reasons already given.

The statute has not distinguished, and therefore the courts can not distinguish, realty corporations from other corporations not specifically enumerated.

CONCLUSION.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed and the cause remanded to the District Court with instructions to dismiss the same with costs to the Government.

WILLIAM WALLACE, JR.,
Assistant Attorney General.

JULY, 1915.

○

No. 246.

Office Supreme Court, U. S.
FILED
SEP 24 1915
JAMES D. MAHER
CLERK

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1915.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE OF NEW YORK,

Petitioner,

against

THE FORTY-TWO BROADWAY COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

BALDWIN & HUTCHINS,
Attorneys for
THE FORTY-TWO BROADWAY COMPANY,
Respondent.

ROGER S. BALDWIN,
Counsel.

The Evening Post Job Printing Office, Inc., 156 Fulton St., N. Y.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1915.

CHARLES W. ANDERSON, Collector of Internal Revenue of New York,
Petitioner,
AGAINST
THE FORTY-TWO BROADWAY COMPANY.

No. 246.

BRIEF FOR RESPONDENT.

Statement of the Case.

A tax of $1,781.36 was erroneously imposed and collected by the United States Government, to recover which this action was brought. The action was tried by the United States District Court under an Agreed Statement of Facts (R., 17 to 35), without a jury, a jury having been expressly waived in writing (R., 16). The Circuit Court of Appeals has unanimously affirmed the judgment of the District Court in favor of The Forty-two Broadway Company for the amount above mentioned with interest.

Two questions of construction of the United States

Corporation Tax Act contained in Section 38 of the Act of Congress, approved August 5th, 1909, 36 Stat., 113, are here presented for determination;

FIRST: Should interest payments on bonds of a corporation, and especially of a corporation doing essentially a real estate or realty business, which bonds are secured by mortgages on real property of such corporation, be allowed to be deducted as a part of the ordinary and necessary expenses of the corporation in the maintenance and operation of its business and properties, required to be made as a condition to the continued use or possession of its property.

SECOND: If such interest payments are allowed to be so deducted, should, as provided by the Statute, and as claimed by Respondent, the interest "actually paid" within the year be so allowed, or, as ruled by the Treasury Department of the Government, should only the interest *accrued* within the year be allowed to be deducted.

The first paragraph of such Corporation Tax Act provides as follows:

> "That every corporation * * * shall be subject to pay annually a special excise tax * * * equivalent to one per centum upon the entire *net* income over and above five thousand dollars *received* by it from all sources during such year."

The Second paragraph of such Corporation Tax Act, allowing deductions from gross income in order to ascertain the net income upon which the tax should be based, provides as follows:

> "SECOND. Such *net* income shall be ascertained by deducting from the gross amount of the income of such corporation * * * *received* within the year from all sources, (first) *all* the *ordinary and necessary* expenses *actually paid* within the year out of income in the maintenance and operation of its business and prop-

erties, including *all* charges such as rentals or franchise payments, *required to be made as a condition to the continued use or possession of property;* * * * (third) interest *actually paid* within the year on its *bonded* or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, * * * outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest *actually paid* by it within the year on deposits * * *".

Italics are our own and for the purpose of designating those words to which special reference will later be made on this brief.

The Facts.

The Respondent was organized for the purpose of acquiring the property known as No. 42 Broadway, New York City, and constructing and operating an office building thereon, and has at no time transacted any other business (R., 21). The capital stock of the Respondent is and has always been only $600, and the funds with which it acquired title to such property and constructed and operated such office building were obtained, with the exception of the $600 capital stock above referred to, entirely through loans made to such company (R., 18).

As is shown in Paragraph XVII of the Agreed Statement of Facts (R., 20), the financial plans and arrangements of the Respondent were of a character customarily followed and adopted by realty companies in New York City at the times in question.

If interest on its mortgages is to be figured as an expense of operation, the Respondent was at all times operated at a loss, and has had no net in-

come, and particularly during the year ending December 31st, 1910, had or earned no net income, the income and receipts of such Company in no year exceeding the expense of operating its building and paying interest and other charges and expenses against it (R., 18).

The interest, which it is claimed should be allowed as a deduction from gross income in order to arrive at the net income upon which the tax of the Respondent should be based, all of which interest was *actually paid* within the year 1910, and paid out of the income of the Respondent, amounted, as shown in paragraph XI of the Agreed Statement of Facts (R., 19), to $339,516.93, of which $160,000 was interest accruing and paid on mortgages on the 42 Broadway building in 1910, $76,527.77 was interest accruing on mortgages on the 42 Broadway building prior to 1910, but paid in 1910, and the balance was interest on other indebtedness of the Respondent not secured by mortgage, part of which accrued in 1910, but all of which was paid in 1910.

The net income of the Respondent for the year 1910, as claimed by the Government, without allowing for any such interest payments, except to the extent of 6 per cent. on the capital stock of $600, or in other words, $36, was $178,135.75, making the 1 per cent. tax on such net income amount to $1,781.36. Provided, therefore, the contentions of the Respondant are sustained by this Court, it is only necessary for the Respondent, in order to be entitled to judgment for the amount of the tax paid, to be entitled to a deduction, from such net income, of the amount of the interest paid during the year 1910 on its mortgages, as the interest paid on such mortgages alone exceeds the net income claimed by the Government as a basis for the computation of the tax. We may therefore disregard the interest paid on the other indebtedness of the Company.

It is admitted, as shown by paragraph XVII of

the Agreed Statement of Facts (R., 20) that all of the interest above referred to is an ordinary and usual expense of realty companies of the character of Respondent, although in making this admission, the Government does not admit that the payment of such interest is "an ordinary and necessary expense" within the meaning of the Act. It is, however, admitted, as shown by paragraph XI of the Agreed Statement of Facts (R., 19), that the interest in question was paid out of the income of Respondent in accordance with the provisions of its mortgages, and that the rates of such interest were those ordinarily paid on mortgages of a realty corporation such as that of Respondent. It is further admitted that, if such interest had not been paid, the mortgages would have fallen due, and that Respondent would have been subject to the foreclosure of its mortgages, and that if such mortgages had been foreclosed, the Respondent would have lost its property.

The District Court held (209 Fed. 991, R., 36) that interest paid by Respondent on its mortgages was one of "the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties," and was a charge "such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property." The Circuit Court of Appeals for the Second Circuit sustained the District Court (213 Fed. 177, R., 43) and further held that interest actually paid within the year, though previously accruing, should also be deducted under the Act.

ARGUMENT.

POINT I.

The interest on the mortgages of The Forty-two Broadway Company was a part of the ordinary and necessary expenses of the company in the maintenance and operation of its business and properties and required to be made as a condition to the continued use or possession of property.

1. It is well settled that the tax imposed, under Section 38 of the Act of Congress of August 5th, 1909, is an *excise* tax, rather than an *income* tax, but we respectfully submit that whatever the tax may be called, it must be, under the terms of the Act, "*equivalent*" to one per cent. upon the "*net income*" of the corporation over and above $5,000 "*received*" by the corporation during the taxable year.

This presupposes the existence of a net income, and a net income "*received*," not *accrued*. The Respondent had no *actual* net income for the year ending December 31st, 1910 (R., 18). In addition to this apparent fact, however, it is submitted that the Respondent had no net income, as *ascertained* by the terms of paragraph "Second" of the Act.

Such paragraph "Second" provides that the net income of a corporation shall be ascertained by making certain deductions from its gross income, among which are

> "(first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of

its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property."

The payments by the Respondent of interest on its mortgages were certainly a part of "*all ordinary and necessary*" expenses of the corporation. No expense could be more ordinary and necessary than this one, and it should be noted that the language of this Act expressly includes "*all*" ordinary and necessary expenses.

It is admitted that the interest in question was "*actually paid*" by Respondent (R., 19), and in this connection it should be noted that the expenses referred to in the Act are not those which have *accrued*, but those which have been "*paid*," the necessity of payment being further emphasized by the word "actually" qualifying the word "paid". This language, repeated several times in the subdivision marked "(Second)" of the Act and the provision in the first paragraph of the Act, which provides that the tax shall be equivalent to one per centum upon the entire net income of the corporation over and above five thousand dollars "*received*" by it from all sources, should settle, once and for all, that the deductions under the Act are determined by actual payments, and not, as ruled by the Treasury Department, by accruals.

It is further admitted that the interest paid by Respondent was paid "*within the year*" and was paid "*out of income*" (R , 19).

Such interest payments were clearly made "*in the maintenance and operation of its*", the Respondent's "*business and properties.*" In the case of all corporations, but particularly in the case of a corporation organized for the business of dealing in a specific parcel of real property, such payments are one, if not the most important, of the ordinary and

necessary expenses of maintenance and operation of the business and properties of the corporation.

Such interest payments were further certainly one of "*all charges*" against the property of the corporation, such language clearly embracing the most usual and, next to taxes, the most fundamental charge, against real property, namely, interest on mortgages. It certainly could not have been intended by Congress, nor should it be held, that all the rest of the language used in connection with deductions allowed under subdivision "(first)" of paragraph Second of the Act should be so negatived and limited by the use, after the words "all charges", of the words "such as rentals or franchise payments", so as to take out of the meaning of the Act the chief item of expense paid by a corporation, which item falls within all the other requirements of the Act.

There is also no question but that such payments were "*required to be made as a condition to the continued use or possession of property.*" There is, as above stated, certainly no expense which it is more necessary to pay for the continued use or possession of property than that of interest on the mortgages on such property, and no expense the failure to pay which will more quickly or certainly result in the loss of property.

2. While interest payments on mortgages are always a part of the ordinary and necessary expenses of a corporation, such payments were particularly so in the case of this specific corporation, organized for and transacting a specific piece of realty business—namely, the purchase of a particular parcel of land, and the erection and operation thereon of a large office building.

If it were necessary, a distinction might be made between a corporation such as Respondent transacting a business such as the business of Respondent

and a corporation conducting other forms of business. In the case of the Respondent, the mortgaging of its property was not incidental to its business, but formed one of the main features of its business. The whole capital of Respondent was bound up in this one venture and the payment of interest on its mortgages constituted its chief item of expense. It is also interesting to note, and we submit that this should have some weight with this Court, that, apart from any technical construction of the Act it is undisputed as a matter of *fact* that the payment of such interest was a part of the "ordinary and necessary expense" of Respondent paid "in the maintenance and operation of its business and properties" (R., 19), and that such payment and expense were, as provided by the Act under the first subdivision of allowable deductions, "required to be made as a condition to the continued use or possession of property" (R., 19).

As pointed out by the Circuit Court of Appeals in its opinion, the interest paid by the ordinary corporation on its bonded or other indebtedness in the conduct of a general business is, of course, quite distinguishable from the interest on the mortgages here in question, and in fact is distinguished by the Act itself The language used in the Act shows that Congress included the interest on mortgages of this character as a part of the ordinary and necessary expenses of a corporation in the maintenance and operation of its business and properties, leaving, as falling under subdivision (third) of allowable deductions, such interest as might be paid on other bonded or other indebtedness of the corporation, the failure to pay which would not result in foreclosure and the consequent deprivation of the use or possession of property.

The Respondent of course admits that it was doing business within the meaning of the Act as

construed by this Court in the cases cited by the Government on its brief.

3. It is maintained by the Government that the interest on the mortgages above referred to is specifically allowed under the deduction marked "(third)" in the Act, and that, therefore, the allowance of such interest is limited by the terms of such paragraph of the Act allowing such deduction. This contention, we respectfully submit, is unsound. The deduction of interest on mortgages is clearly within the terms of the deduction marked "(first)", if such interest *is a part of ordinary and necessary expenses, and required to be paid as a condition to the continued use and possession of property*, and such deduction is clearly allowable under such portion of the Act, although it may also be allowable under other portions. As stated by the Circuit Court of Appeals in its opinion, both Subdivision "(first)" and Subdivision "(third)" may be consistently construed so that both cover interest payments, Subdivision "(third)" being considered as referring more particularly to the usual corporate indebtedness.

In this connection it may be observed that under the deduction marked "(third)," the interest referred to is the interest on "*bonded*" or other indebtedness of the corporation. We have, however, found no authority to the effect that the word "bond" includes a mortgage, and the word should not be so construed. A bond and a mortgage are separate securities though for the same debt, and the one does not include the other. Thus a bond is defined in Bouvier's Law Dictionary as being "an obligation in writing and under seal," and this definition is supported by the authorities.

See Koshkonong *vs.* Burton, 104 U. S. 668, 673.

It might be urged, therefore, that interest on the indebtedness of a corporation secured by a mortgage is not specifically included within deduction "(third)" of the Act, while the interest on indebtedness secured by mortgage, such as here in question, is specifically included within deduction "(first)" among "ordinary and necessary expenses," and as a payment "required to be made as a condition to the continued use or possession of property."

4. It has been suggested that Congress intended to prevent the carrying on of business by corporations with a small capital stock and a large bonded indebtedness. If this is so, such fact is not stated in the Act, but whatever may be contended as to the purpose of Congress, it will, we are sure, not be contended that any Federal or State Legislature in these times would intentionally pass any legislation encouraging over-capitalization, or the capitalization of real property at its gross value rather than at the value of the equity owned by the corporation. If the contention of the Government in this connection is correct, it would follow, necessarily, that in order to be able to deduct interest on its mortgages as an expense, a corporation which holds real property subject to mortgage would have to incorporate for an amount largely in excess of the real value of its interest in such property. In other words where a corporation holds real property, subject to a mortgage of two-thirds of the value of such property, as the great majority of the real property in New York City is to-day held, the capitalization of such corporation, in order to meet this contention, would have to be at least three times the real value of the property to represent which its capital stock was issued. Such a result, of course, was never intended by the United States Congress, and any construction which involves any such result

must be erroneous and unintended by those who created the language of the Act.

The form of the organization of Respondent called for a small capitalization and a large indebtedness. This was not unusual or in any way improper. The purpose of Congress in limiting the deduction of interest on general indebtedness was without doubt to prevent the incurring of unusual and unfair debts in order to escape the corporate tax. It was appreciated, however, as is indicated by the Act itself, that the allowance of interest on an indebtedness which was secured by a mortgage on property would not be so open to the danger above referred to, while the safeguards thrown around such expense, namely, that it should be *ordinary* and *necessary*, and that it should be an expense which was *required to be made as a condition to the use or possession of property*, would fully protect the Government against unfair practices.

A construction of the Act which would deprive mortgagors of the right to deduct, as an expense, interest paid on mortgages, would work a great hardship and injustice imposed upon no other class of taxpayers. Such construction would create an arbitrary and unreasonable classification, and the Act if so construed, might on this ground be held to be unconstitutional under the Fifth Amendment to the Constitution of the United States.

Connolly *vs.* Union Sewer Pipe Co., 184 U. S. 540, 560.

Cotting *vs.* Kansas City Stock Yards Co., 183 U. S. 79, 111.

POINT II.

If, in construing this Tax Act, there is any reasonable doubt as to what construction should be placed upon it, all reasonable doubts should be resolved against the Government and in favor of the taxpayer.

The contention of Respondent does not violate any of the general rules of construction, including those referred to by the Government on its brief. On the contrary, we submit that the contention of the Respondent as to the proper construction to be placed upon the Act in question is essentially in accordance with such rules.

If, however, there is any doubt as to the construction which should be placed upon this or any other portion of the Corporation Tax Act, it is, of course, well settled, in construing a statute imposing a tax, that all reasonable doubts should be resolved against the Government and in favor of the person taxed.

There are no authorities which can be cited on the precise question involved, as the issue here raised has not before this been presented for adjudication. The question, however, has been a much discussed one, and was raised early in the enforcement of the Corporation Tax Act, as is evidenced by the opinion of the Honorable George W. Wickersham, Attorney General of the United States (28 Opin. A. G. 199), which opinion is dated February 21st, 1910, and referred to by the Government on its brief. In the giving of this opinion the Attorney General, as he stated, departed from the general custom and rendered an opinion upon a merely hypothetical and general question in view of the great importance of the question to the many interests

affected thereby. The equity of the position of Respondent would seem to have been recognized by the Attorney General, as in his opinion above referred to, he endeavored to distinguish, for the benefit of corporations, between those cases where the interest payments were on mortgages securing bonds of the corporation itself, interest on which he ruled could not be deducted, and those cases where interest payments were on bonds of other corporations or individuals not assumed by the corporation, interest on which he ruled could be deducted. This is a distinction upon which the Government lays great stress in its brief presented to this court, and is a distinction which was for a time adopted by the Treasury Department of the United States, but later was not followed, thus repudiating the part of the opinion of the Attorney General in this connection, which was favorable to the tax payer, while to sustain its present position the Government cites that part of such opinion which on the precise question here presented might be considered as favorable to the Government. (See form of Return 1032 issued by the Treasury Department, and Article 148 of Treasury Regulations under new Income Tax Laws of 1913, where the language used in this connection is almost identical with the language used in the old Act of 1909.)

In the last paragraph of his opinion, the learned Attorney General stated that a payment of interest on a mortgage, which had not been assumed by a corporation, would not be a payment, under Subdivision "(Third)" of paragraph Second of the Act, of interest on "*its* indebtedness", this being the language of the Act, and so would be deductible, and continues as follows:

> "The interest accruing upon such charge or encumbrance would certainly fall within the description of the first clause of the second paragraph of the section under consideration as

> one of the 'charges * * * required to be made as a condition to the continued use or possession of property,' and therefore would be deductible as such."

Here is substantiation from the Government itself of our contention that the payment of interest on a mortgage falls within the language of Sub-division (first) of the Act, if for no other reason, certainly as a "*charge*" required to be made as a condition to the continued use or possession of property.

The attempt to distinguish in this connection between an obligation *in rem* and an obligation *in personam* is not convincing. Whether the present or a prior owner of the equity in land is personally liable for the interest on a mortgage on the property, has no bearing on the question as to whether such interest is an "ordinary and necessary expense," or is a payment "required to be made as a condition to the continued use or possession of property." The expense is the same by whomsoever it is paid, and whether or not there has been a transfer of the property since the mortgage has been placed on it.

The suggestion that holders of the mortgages on the property of the Respondent were not adverse to the Respondent, and that loss of possession would in no case have resulted, is not supported by the Statement of Facts. The failure of a person to enforce his legal rights temporarily can surely not determine the character of the payment made or to be made. As a matter of fact the interest payments were made and to set up nonpayment as a condition precedent to determining whether a payment is necessary for the continued use or possession of property would, indeed, be a singular method of construction.

POINT III.

The Corporation Tax Act should be administered upon the basis of "receipts" and "payments", as expressly provided in the law.

If the court should decide in favor of the Respondent, the question will arise as to what portion of the $339,516.93 of interest paid by Respondent (R., 19) should be allowed as a deductible expense. It would seem clear that the item of $135,000, interest on first mortgage accrued and paid in 1910, and the item of $25,000. interest on second mortgage accrued and paid in 1910 should be allowed, and such allowances aggregating $160,000, would, if deducted from the assessment of $178,136.75, reduce such assessment against The Forty-two Broadway Company for the year 1910 to $18,135.75, without reference to the specific deduction of $5,000 allowed by the Act. The items of interest amounting to $47,715.16 and $55,274 paid on other indebtedness of the Company, not being interest on mortgages, might not be considered by the Court as properly deductible under paragraph (first) of the Act, not being required to be made as a condition to the continued use or possession of property. If the Court should come to this conclusion, the only remaining item of interest claimed by Respondent as a deductible expense is the item of $76,527.77, which was interest on a second mortgage. Such interest, however, although *paid* in 1910, *accrued* prior to 1910.

The allowance or disallowance of this item depends upon the construction which the Court may give to the word "paid" contained in the Act. An examination of paragraph Second of the Act will

show that all the deductions there referred to are based upon *payments*, and not upon *accruals*. The Treasury Department of the United States, among other regulations with respect to what deductions shall be allowed, ruled, as shown by Note B annexed to the prescribed form of Return (R., 37), as follows:

> "the deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the Return and entered on its books from January 1st to December 31,"

thereby adding to the Act the condition that the expense shall not only be "paid" by the corporation, but shall also be "entered on its books from January 1st to December 31st." The Treasury Department has further construed the Act as based upon *accruals* rather than, as stated in the Act, upon *payments*. This construction would seem to be without authority in the Act and improper, and, as above set forth, it is claimed by Respondent that the interest on its second mortgage, which interest accrued prior to 1910, but was *paid* in 1910, should be allowed as a further deduction from the gross income of the Company for the year 1910, thereby wiping off the assessment for such year, and entitling the Respondent under the stipulation herein (R., 20) to a judgment against the Collector of Internal Revenue for the sum of $1,781.36, with interest from April 29th, 1911, which judgment should be allowed in this action. This is the view taken by the Circuit Court of Appeals for the Second Circuit, which in its opinion herein says:

> "The Act expressly defines both the maintenance expense and the interest on indebtedness to be such as is 'actually paid within the year.' This seems to us reasonable, because the net income which measures the tax is the income received during the year, and the deduction should be of sums paid during the year."

This is also the view taken by the Court in Mutual Benefit Life Insurance Co. *v.* Herold, 198 Fed. Rep., 199, 214, 215, affirmed by the Circuit Court of Appeal for the Third Circuit, 201 Fed. Rep., 918, which is the only other case we have found in which this question, arising under the Act of 1909, has been determined.

As urged, in another connection, by the Government in its brief (p. 13) the tax schedules should be computed "*not* according to principles of bookkeeping, which would be applied by the accountants or officers, or stockholders of the corporation, but upon a basis specifically set forth by Congress in the Act itself."

Conclusion.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

Dated, New York, September, 1915.

BALDWIN & HUTCHINS,
Attorneys for
The Forty-two Broadway Company.

ROGER S. BALDWIN,
Counsel.

ANDERSON, COLLECTOR OF INTERNAL REVENUE, *v.* THE FORTY-TWO BROADWAY COMPANY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 246. Argued October 18, 1915.—Decided November 8, 1915.

The Corporation Tax of 1909, 36 Stat. 112, was not an income tax but an excise upon the conduct of business in a corporate capacity, the tax being measured by reference to the income in a manner prescribed by the act itself.

Where a corporation carries a current indebtedness exceeding the amount of its paid-up capital stock, the interest deductions allowed in determining the net income subject to the corporation tax is limited to so much of the indebtedness as does not exceed the capital.

Congress has power to adopt a basis of distinction between corporations carrying indebtedness that exceeds the amount of the capital and those that do not, and the provision in the Corporation Tax Act limiting the amount of interest deductions to so much of the indebtedness as does not exceed the capital stock is not an arbitrary classification.

The operations of corporations having indebtedness exceeding their capital stock may be considered as conducted more for the benefit of the creditors than of the stockholders, and the contributions of the corporation to the expenses of the Government be admeasured with this fact in view; and so *held* as to a corporation having $600 capital stock and $4,750,000 bonded indebtedness.

THE facts, which involve the construction of the Corporation Tax Act of 1909 and the liability of a realty corporation to pay the tax imposed thereby, are stated in the opinion.

Mr. Assistant Attorney General Wallace for the petitioner.

Mr. Roger S. Baldwin for the respondent.

MR. JUSTICE PITNEY delivered the opinion of the court.

This was an action to recover a tax alleged to have been erroneously imposed upon respondent for the year 1910 under the Corporation Tax Act of August 5, 1909 (36 Stat. 112, c. 6, § 38), and paid under protest, respondents contending that in ascertaining its net income for the purposes of the tax the entire amount of the interest paid by it within the year upon its mortgage indebtedness ought to have been allowed, the result of which would have been to leave no net income to be taxed; whereas the assessing officer allowed a deduction of interest upon an amount equal only to the capital stock of the company.

Respondent is a corporation of the class commonly known as realty corporations, was organized for the purpose of constructing and renting a building in the city of New York, and transacts no other business. Its paid-up capital stock is only $600, while it has a bonded indebtedness of $4,750,000, secured by mortgages upon its real estate, consisting of a piece of land purchased and a building constructed upon it substantially with borrowed money, to secure the repayment of which the bonds and mortgages were given.

Both the District Court (209 Fed. Rep. 991) and the Circuit Court of Appeals (213 Fed. Rep. 777) held that the interest payments upon the entire mortgage indebtedness were deductible from the gross income of the corporation under clause 1 of paragraph 2 of § 38 of the Act, and gave judgment against the Collector for a refund of the entire tax.

Those portions of the section that are essential to a determination of the controversy are set forth in the margin.[1] The District Court, conceding that the provi-

[1] SEC. 38. That every corporation . . . organized for profit and having a capital stock represented by shares . . . shall be subject to pay annually a special excise tax with respect to the carrying on or

sion of the third clause of the second paragraph, standing alone, would constitute sufficient authority for the action of the assessor, nevertheless held that the force of this provision must be limited, in view of the general purpose of the section to tax only "net income" (construed to mean "gross income after deducting all outgo necessarily incident to the business"), and also in view of the first clause of the second paragraph, which permits of a deduction of "all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property." The court therefore held that, in the case of such a corporation as respondent, the amounts paid for interest on the mortgages must be deducted in order to arrive at net income. The Circuit Court of Appeals entertained a similar view, holding that such interest payments, in the case of a realty corporation, were ordinary and necessary expenses in the maintenance and operation of the business, and were also charges required

---

doing business by such corporation . . . equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year . . . *Provided, however*, That nothing in this section contained shall apply to—[certain specified classes of organizations, not including realty corporations].

Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation . . . received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; . . . (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, . . . and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits; . . .

to be paid as a condition to the continued use or possession of its property, within the meaning of sub-division 1; and that sub-division 3 must be limited in its effect to "the usual corporate indebtedness which is not an ordinary expense of maintenance, nor a charge, payment of which is a condition of the continued use or possession of property."

With these views we cannot agree. There was error, as it seems to us, in seeking a theoretically accurate definition of "net income," instead of adopting the meaning which is so clearly defined in the Act itself.

As has been repeatedly pointed out by this court in previous cases (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 145, 150, 151; *McCoach* v. *Minehill Railway*, 228 U. S. 295, 306 *et seq.*; *United States* v. *Whitridge*, 231 U. S. 144, 147; *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 414), the act of 1909 was not in any proper sense an income tax law, nor intended as such, but was an excise upon the conduct of business in a corporate capacity, the tax being measured by reference to the income in a manner prescribed by the act itself. And it is very clear, from a reading of § 38, that the phrase "entire net income," as used in its first paragraph, has no other meaning than that which is particularly set forth in the second paragraph, which declares, in terms, how "such net income shall be ascertained." It may well be that mortgage interest may, under special circumstances, be treated as among the "ordinary and necessary expenses," or as included among the charges "required to be made as a condition to the continued use or possession of property." (See 28 Opin. A. G. 198.) But interest upon the "bonded or other indebtedness" of the corporation, whether such indebtedness be secured by mortgage or not, comes within the specific provision of the third clause, whose effect, in our opinion, is not in this respect limited by anything contained in the first. Congress evidently had in view the fact that some corporations (other than banks and like

institutions, which, for obvious reasons, are separately considered), carry a current indebtedness exceeding the amount of the paid-up capital stock, and with respect to such corporations intended to limit the interest deduction to so much of the indebtedness as did not exceed the capital. Nor can we see the least ground for the insistence that this results in an arbitrary classification. It is not necessary to attribute to Congress a purpose to discourage or impose an extra burden upon corporations carrying on their operations with a nominal capital stock, or with an indebtedness largely exceeding the amount of the capital. It is more reasonable to say that Congress deemed that where the indebtedness does exceed the capital it should no longer be treated as an incident, but that the carrying of the indebtedness should be considered as a principal object of the corporate activities, that the operations of such a corporation are conducted more for the benefit of the creditors than of the stockholders, and that the contribution of the corporation to the expenses of the Government should be admeasured with this fact in view. There is no question of the power of Congress to adopt such a basis of distinction, and, since the line must be drawn somewhere, it was certainly not arbitrary to draw it at the precise point where the pecuniary interest of creditors overbalanced that of stockholders.

Judgment reversed, and the cause remanded to the District Court for further proceedings in accordance with this opinion.

MR. JUSTICE MCREYNOLDS took no part in the consideration or decision of this case.